Supreme Court, U.S.
FILED

No. 01-1325 MAR 07 2002

OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

WASHINGTON LEGAL FOUNDATION, ALLEN D. BROWN, DENNIS H. DAUGS, GREG HAYES, and L. DIAN MAXWELL,
Petitioners,

v.

LEGAL FOUNDATION OF WASHINGTON; KATRIN E. FRANK, in her official capacity as President of the Legal Foundation of Washington; and GERRY L. ALEXANDER, BOBBE J. BRIDGE, THOMAS CHAMBERS, FAITH IRELAND, CHARLES W. JOHNSON, BARBARA A. MADSEN, SUSAN OWENS, and CHARLES Z. SMITH, in their official capacities as Justices of the Supreme Court of Washington,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

---

PETITION FOR WRIT OF CERTIORARI

Charles Fried
1525 Massachusetts Ave.
Cambridge, MA 02138
(617) 495-4636

Donald B. Ayer
Cynthia L. Bauerly
Jones, Day, Reavis & Pogue
51 Louisiana Ave., NW
Washington, DC 20001
(202) 879-3939

Daniel J. Popeo
Richard A. Samp
(Counsel of Record)
Washington Legal Foundation
2009 Massachusetts Ave., NW
Washington, DC 20036
(202) 588-0302

James J. Purcell
1218 3rd Ave., #2403
Seattle, WA 98101
(206) 622-5322

Date: March 7, 2002

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

152pp

QUESTIONS PRESENTED

In *Phillips v. Washington Legal Found.*, 524 U.S. 156 (1998), the Court held that the interest on clients' funds held in so-called IOLTA accounts ("Interest on Lawyers' Trust Accounts") was the property of the clients. This case presents two questions:

1. Whether the regulatory scheme for funding state legal services by systematically seizing this property violates the Takings Clause of the Fifth Amendment to the Constitution so that the property owners are entitled to relief.

2. Whether injunctive relief is available to enjoin a State from committing such a violation of the Takings Clause, where the legislative scheme in issue clearly contemplates that no compensation would be paid to the owners of the interest taken, and where the small amount due in any individual case often renders recovery through litigation impractical.

PARTIES TO THE PROCEEDING

Aside from the parties named in the caption, the following were Defendants/Appellees in the court of appeals: Kevin Kelly, in his official capacity as President of the Legal Foundation of Washington; and Barbara Durham, James M. Dolliver, Richard P. Guy, and Philip A. Talmadge, in their official capacities as Justices of the Supreme Court of Washington. Those five individuals no longer serve in the capacities listed and thus are no longer parties to this proceeding.

Petitioner Washington Legal Foundation is a nonstock corporation; it has no parent corporation, and no publicly held company owns any its stock.

TABLE OF CONTENTS

Page

OPINIONS BELOW 1

JURISDICTION 1

CONSTITUTIONAL PROVISIONS AND RULES INVOLVED 1

STATEMENT OF THE CASE 2

REASONS FOR GRANTING THE WRIT 12

I. Review Is Warranted To Resolve the Conflict in the Circuits over Whether Expropriation of IOLTA Funds Constitutes a Fifth Amendment Taking 15

A. The Ninth Circuit's Decision That IOLTA Effects No Unconstitutional Taking Directly Conflicts with the Fifth Circuit's *TEAJF* Decision 15

B. The Ninth Circuit's Decision That No Taking Occurred Is Inconsistent with the Decisions of This Court 19

II. The Court Should Grant Certiorari to Determine Whether Equitable Relief Is Available in Certain Takings Cases 23

Page

A. There Is a Split in the Circuits Over the Availability of Equitable Relief for Governmental Takings that Result From Compelled Transfers of Money 23

B. The Decision Below Is Contrary to the Decisions of this Court, Which Recognize the Availability of Equitable Relief in the Absence of a Reasonable, Certain and Adequate Damages Remedy 26

CONCLUSION 30

APPENDIX A, Opinion of the U.S. Court of Appeals for the Ninth Circuit, November 14, 2001 . . . . . 1a

APPENDIX B, Opinion of the U.S. Court of Appeals for the Ninth Circuit, January 10, 2001 . . . . . 52a

APPENDIX C, Opinion of the U.S. District Court for the Western District of Washington, January 30, 1998 . 86a

APPENDIX D, Order of the U.S. Court of Appeals for the Ninth Circuit granting rehearing, May 9, 2001 . . . . 97a

APPENDIX E, Constitutional Provisions and Rules . 98a

APPENDIX F, Declaration of Gerald R. Wheeler, November 3, 1997 . . . . . 108a

TABLE OF AUTHORITIES

Page

Cases:

Babbitt v. Youpee, 519 U.S. 234 (1997) 29
Bennion, Van Camp, Hagan & Ruhl v. Kassler Escrow, Inc., 96 Wn.2d 443, 635 P.2d 730 (1981) . . . 3
Boston Chamber of Commerce v. City of Boston, 217 U.S. 189 (1910) 22
Cherokee Nation v. S. Kansas R. Co., 135 U.S. 641 (1890) 26
Citizens for the Preservation of Constitutional Rights v. Marshall, No. 02-cv-10125MLW (D. Mass., filed Jan. 23, 2002) 18
Concrete Pipe and Products v. Constr. Laborers Pension Trust, 508 U.S. 602 (1993) 27
Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211 (1985) 27
Duke Power Co. v. Carolina Environmental Study Group, 438 U.S. 59 (1978) 23, 24, 26, 27
Eastern Enterprises v. Apfel, 524 U.S. 498 (1998) 24, 28
In re Chateaugay Corp., 53 F.3d 478 (2d Cir. 1995) 25, 28
Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982) 10, 17, 20
Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992) 9, 17
Palazzolo v. United States, 121 S. Ct. 2448 (2001) 17
Penn Central Transportation Co. v. City of New York, 438 U.S. 104 (1978) . . . . . *passim*

Page

Phillips v. Washington Legal Found.,
521 U.S. 1117 (1997) (granting review) 19-20
Phillips v. Washington Legal Found.,
524 U.S. 156 (1998) . . . . . *passim*
Presault v. Interstate Commerce Comm.,
494 U.S. 1 (1990) 26
Ruckelshaus v. Monsanto Co.,
467 U.S. 986 (1984) 24, 26
Student Loan Mktg. Ass'n v. Riley,
104 F.3d 397 (D.C. Cir. 1997) 25, 28
Transohio Sav. Bank v. Director, Office of Thrift Supervision, 967 F.2d 598 (D.C. Cir. 1992) . . . 23, 24
United States v. Pewee Coal Co.,
341 U.S. 114 (1951) 22
United States v. Sperry Corp.,
493 U.S. 52 (1989) 13, 21
Washington Legal Found. v. Texas Equal Access to Justice Found., 270 F.3d 180 (5th Cir. 2001) . . *passim*
Webb's Fabulous Pharmacies, Inc. v. Beckwith,
449 U.S. 155 (1980) 13, 20, 21, 22, 27

Statutes and Constitutional Provisions:

U.S. Const.:
Amend. I 8, 12
Amend. V . . . . . *passim*
Takings Clause . . . . . *passim*
Amend. XI 30

12 U.S.C. § 371a 5
12 U.S.C. § 1464(b)(1)(B) 5

Page

12 U.S.C. § 1828(g) 5
12 U.S.C. § 1832 5
12 U.S.C. § 1832(a)(2) 5

Rules:

Washington Admission to Practice Rules ("APRs")
APR 12 3
APR 12(h) . . . . . *passim*
APR 12.1 . . . . . *passim*
APR 12.1(c)(2) 4
APR 12.1(c)(3) 4

Washington Code of Prof. Responsibility, DR 9-102 . 2, 3
DR 9-102(C)(1) and (4) 2
DR 9-102(C)(3) 3

Washington Rules of Prof. Conduct ("RPC") 1.14 3

PETITION FOR A WRIT OF CERTIORARI

Petitioners Washington Legal Foundation, Allen D. Brown, Dennis H. Daugs, Greg Hayes, and L. Dian Maxwell respectfully petition this Court for a writ of certiorari to review the judgment of the U.S. Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The *en banc* opinion of the court of appeals (App. 1a-51a) is reported at 271 F.3d 835. The opinion of the court of appeals panel that initially heard this case (App. 52a-85a) is reported at 236 F.3d 1097. The opinion of the district court granting Respondents' motions for summary judgment and denying Petitioners' motion for summary judgment (App. 86a-96a) is not reported. The order granting *en banc* review (App. 97a) is reported at 248 F.3d 1201.

JURISDICTION

The judgment of the court of appeals was entered on November 14, 2001. On February 8, 2002, Justice O'Connor extended the time for filing a petition for a writ of certiorari to and including March 7, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND RULES INVOLVED

The relevant provisions of the Fifth Amendment to the Constitution and of the Washington State Admissions to Practice Rules and Rules of Professional Conduct are set forth in the Appendix to this Petition. App. 98a-108a.

STATEMENT OF THE CASE

This case challenges the constitutionality of the Washington State IOLTA ("Interest on Lawyers Trust Accounts") program. Under that program, funds belonging to certain individuals hiring lawyers and real estate professionals in Washington are used -- without the consent and usually without the knowledge of those individuals -- to finance a variety of legal services programs. Petitioners seek review of a 7-4 *en banc* decision of the U.S. Court of Appeals for the Ninth Circuit that the IOLTA program does not violate their rights under the Takings Clause of the Fifth Amendment.

1. By an order dated June 19, 1984, the Supreme Court of Washington created the Washington IOLTA program. Pursuant to that order, the court incorporated and established Respondent Legal Foundation of Washington ("LFofW") as a nonprofit corporation, with Articles of Incorporation and Bylaws promulgated by the Court. The order also amended Disciplinary Rule ("DR") 9-102 of the Washington Code of Professional Responsibility ("CPR"), which imposed obligations on Washington attorneys regarding "Preserving Identity of Funds and Property of a Client." The amendment provided that an attorney receiving client funds that were "nominal in amount" or were "expected to be held for a short period of time" must create an unsegregated interest-bearing account (an "IOLTA account") and direct the depository institution to pay interest earned on the account to the LFofW. CPR DR 9-102(C)(1) and (4). The amendment further provided that all client funds were to be placed into the IOLTA account unless they were deposited in another interest-bearing account that resulted in the creation of "a

positive net return for the client" (defined as interest paid on the account less maintenance costs and the costs of accounting for the interest). DR 9-102(C)(3). The court subsequently replaced the Code of Professional Responsibility with the Rules of Professional Conduct ("RPC"); the provisions of CPR DR 9-102 were incorporated into RPC 1.14.[1]

Both before and after 1983, many real estate transactions in Washington have been consummated by escrow companies and title insurance companies, without the assistance of attorneys. In those cases, legal documents used to complete the transactions have been selected by trained laypersons familiar with the legal requirements of such transactions. In the early 1980s, the Supreme Court of Washington ruled that such laypersons were engaged in the unauthorized practice of law. *Bennion, Van Camp, Hagan & Ruhl v. Kassler Escrow, Inc.*, 96 Wn.2d 443, 635 P.2d 730 (1981). That decision was controversial among some members of the state legislature, who argued that the court had exceeded its constitutional bounds by attempting to regulate a field theretofore regulated by the legislature. The court attempted to settle the controversy in 1983 by adopting Admission to Practice Rule ("APR") 12. APR 12 established a procedure whereby nonlawyers could be licensed to select appropriate legal documents for use in real estate settlements. APR 12 established a Limited Practice Board with the responsibility for licensing such LPOs (Limited Practice Officers, also known as Certified Closing Officers).

---

[1] A copy of the most recent version of RPC 1.14 is set forth at App. 99a-102a.

On September 21, 1995, the Supreme Court of Washington adopted a new APR 12(h) and 12.1 in order to make LPOs subject to the IOLTA Program. APR 12(h) and 12.1 make clear that LPOs' obligations to maintain and use IOLTA accounts are identical to attorneys' IOLTA obligations.[2] APR 12(h) provides that LPOs must comply with APR 12.1. APR 12.1 in turn provides that all funds received in connection with a transaction being closed by an LPO must be placed in an interest-bearing account. The interest-bearing account must be an IOLTA account (with interest payable to the LFofW), except that the funds may be placed in a non-IOLTA interest-bearing account if and only if doing so results in the creation of "a positive net return for the client" (defined as interest paid on the account less maintenance costs and the costs of accounting for the interest). APR 12.1(c)(2) and (3).

Since IOLTA's inception in 1985, interest generated by Washington IOLTA accounts has generally amounted to between $2.5 and $4.0 million per year. App. 7a. LFofW is authorized under its Articles of Incorporation to award grants to § 501(c)(3) corporations, the only limitation on grants being that they must be for the purpose of providing legal services and education to the public in civil law matters.

2. The escrow and title insurance industries provide escrow services in Washington to buyers and sellers in connection with real estate transactions. Those services include holding customer funds in escrow accounts for a short period of time while the transactions are being completed.

---

[2] Copies of APR 12(h) and 12.1 are set forth at App. 103a-108a.

Historically, escrow companies and title companies have placed customer trust funds into non-interest-bearing checking accounts. The accounts were non-interest-bearing because federal law (since the Depression) has prohibited federally-insured banks and savings and loans from paying interest on *checking* accounts. *See* 12 U.S.C. §§ 371a, 1464(b)(1)(B), 1828(g). *See also* Declaration of Gerald R. Wheeler ¶ 5, App. 110a.[3] Federal restrictions on interest payments by financial institutions have been relaxed somewhat since 1980, so that banks are now authorized to offer Negotiable Order of Withdrawal (NOW) accounts, which operate like traditional checking accounts yet are not considered "demand" accounts and thus are permitted to pay interest. 12 U.S.C. § 1832. However, escrow and title companies have never deemed NOW accounts to be realistic options for their trust funds due to the difficulty in crediting the proper amount of interest to each person whose funds have passed through the escrow account. App. 110a. Another reason that NOW accounts have not been employed is that they may not be used for funds belonging to a for-profit corporation, and escrow and title companies on occasion handle corporate funds. 12 U.S.C. § 1832(a)(2); App. 110a.

Although banks have not paid interest on escrow accounts, in lieu thereof they have provided what are referred to in the industry as "earnings credits." App. 111a. These credits can generally be applied against fees that would otherwise be payable to the bank for a wide variety of

---

[3] The Wheeler Declaration, set forth at App. 109a-112a, was attached to the motion for summary judgment filed by Petitioners in the district court.

services rendered by the bank. *Id.* Such credits directly reduce costs to customers for services, including escrow trust accounting services and wire transfers. *Id.*

The adoption of APR 12(h) and 12.1 has significantly altered that historical practice. APR 12.1 provides that all funds received in connection with a transaction being closed by an LPO must be placed in an interest-bearing account; as a practical matter, that requires placing the funds into an IOLTA account with interest payable to LFofW. Following the adoption of APR 12(h) and 12.1, many Washington banks have been unwilling to offer earnings credits on escrow accounts. In the absence of such credits, bank customers are now paying for many services that formerly were "free" (in the sense that earnings credits generally were more than sufficient to offset charges for such services). App. 111a. Some or all of those costs inevitably are passed along by escrow and title companies to their customers. App. 112a. Some escrow companies have taken to including those bank charges as a separate item on closing statements. *Id.* Others simply include the bank charges as part of general overhead costs; since overhead costs are a major factor in determining a company's pricing structure, the bank charges ultimately are borne in whole or in part by escrow customers. *Id.*

3. Petitioners Allen D. Brown and Greg Hayes regularly purchase and sell real estate as part of their business dealings. In connection with recent real estate transactions, they have placed their funds in the custody of their escrow companies, and those companies (without the consent of Petitioners) deposited the funds into IOLTA accounts. App. 14a.

Petitioner Dennis H. Daugs owns and operates a small escrow company in Federal Way, Washington. He regularly holds client funds entrusted to him in connection with real estate transactions. App. 15a. As a licensed LPO, he is subject to APR 12.1. Mr. Daugs has determined, however, that compliance with APR 12.1 and payment to LFofW of interest income belonging to his clients would violate his fiduciary obligations to his clients to protect their property. Accordingly, he has refused to participate in the IOLTA program, thereby exposing himself to potential disciplinary action.

Petitioner L. Dian Maxwell is employed by Pacific Northwest Title Company of Washington ("PNW Title"), which provides escrow services in connection with real estate closings. Up until 1996, Ms. Maxwell was a licensed LPO. After Rule 12.1 was adopted, PNW Title determined that it could avoid being subject to the IOLTA program (and thus could save the estimated $50 per transaction cost of participating in the IOLTA program) by requiring all of its employees involved in real estate closings to surrender their LPO licenses. App. 16a.[4] In order to keep her job, Ms. Maxwell surrendered her license. *Id.*

Petitioner Washington Legal Foundation ("WLF") is a public interest law firm whose members include several of the other Petitioners, as well as Washington citizens similarly situated to the other Petitioners.

---

[4] Because PNW Title no longer employs LPOs, its customers now must employ outside counsel to prepare the form legal documents used in connection with real estate transactions.

4. Petitioners filed this action in January 1997 in U.S. District Court for the Western District of Washington, alleging that the IOLTA program violated their rights under the First and Fifth Amendments. Named as defendants were LFofW, its President, and the nine justices of the Supreme Court of Washington -- sued in their official capacities only.

In January 1998, the district court issued an Order and Judgment granting Respondents' motions for summary judgment and denying Petitioners' motion for summary judgment. App. 86a-96a. The district court stated that the existence of a property right in IOLTA interest was "a prerequisite to establishing either a First or Fifth Amendment claim." *Id.* at 92a. The court held that Petitioners lacked any property rights in the IOLTA interest and, accordingly, dismissed their constitutional claims. *Id.* at 94a. The court also rejected Petitioners' alternative claim that the IOLTA program violated their Fifth Amendment rights by failing to compensate them for the use of their funds. *Id.* at 96a.

In January 2001, a Ninth Circuit panel reversed.[5] App. 52a-85a. The panel determined that the interest income in IOLTA accounts belongs to those whose funds generated the income, and that "a government appropriation of that interest for a public purpose is a taking entitling them to just compensation under the Fifth Amendment." App. 85a. The panel remanded the case to the district court for determi-

[5] While the appeal was pending, this Court issued its decision in *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998). *Phillips* held, in a case involving the Texas IOLTA program, that interest earned on IOLTA accounts belongs to those whose funds generated the interest.

nation of an appropriate remedy. *Id.* Rejecting Respondents' argument that the IOLTA program could be upheld under the *ad hoc* approach to Takings Clause claims articulated in *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978), the panel stated, "When the government permanently appropriates all of the interest on IOLTA trust funds, that is a *per se* taking, as when it permanently appropriates by physical invasion of real property." App. 77a (citing *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992)). The panel rejected Respondents' argument that the Takings Clause provides greater protection against government interference with real property rights than against government expropriation of intangible personal property. The panel stated, "This [argument] would imply the nonsensical proposition that a taking would *less* readily be found if a state entirely confiscated people's money from their bank accounts or IRA's than if it installed a sign on their land." App. 74a.

On May 9, 2001, the Ninth Circuit granted Respondents' petition for rehearing *en banc* and vacated the panel decision. App. 97a. On November 14, 2001, the *en banc* appeals court voted 7-4 to affirm the district court in part, vacate in part, and remand. Initially, the court *sua sponte* addressed Petitioners' standing. The court held that Respondents had confiscated funds belonging to Petitioners Brown and Hayes and thus that those two Petitioners had standing to challenge the IOLTA program. App. 14a.

The court also held that Petitioners Daugs, Maxwell, and WLF lacked standing because Washington had not confiscated any property belonging to them, and thus they had no basis for claiming compensation. App. 15a-19a.

Those Petitioners had never, in fact, sought compensatory relief; rather, they had sought injunctive relief. The court's apparent confusion on this point ended up having no effect on its ultimate disposition of their claims, however, because the court held that the injunctive relief sought by Petitioners Daugs, Maxwell, and WLF is not available in Takings Clause cases: "[T]he remedy for the Fifth Amendment violation alleged here is to provide the property owner with just compensation, if a taking has occurred." App. 19a.

Turning to the merits, the court held that Petitioners Brown and Hayes were, indeed, the owners of the interest earned on their IOLTA funds, and it vacated the district court's holding to the contrary. The court rejected Respondents' efforts to distinguish *Phillips*, holding that any differences between Texas and Washington property law with respect to ownership of interest income were "immaterial." App. 24a. The court nonetheless held that Respondents' confiscation of Petitioners' property did not violate the Takings Clause. First, the court concluded that Petitioners' Takings Clause claims should be judged under the *ad hoc* method of analysis outlined in *Penn Central* rather than the *per se* analysis outlined in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 441 (1982). App. 27a-32a. The court said, "The *per se* analysis has not typically been employed outside the context of real property. It is a particularly inapt analysis when the property in question is money." App. 27a. The court thought that application of the *ad hoc Penn Central* approach was especially appropriate in this case because: (1) the property being confiscated from Petitioners was being used to promote the common good, App. 29a; and (2) "Given the highly-regulated nature of the banking industry, individuals should expect that their

commercial transactions, including their bank deposits, will be regulated." App. 31a.

The court noted that courts applying an *ad hoc* analysis often look to three factors in determining whether a taking has occurred: (1) the economic impact of the government's action; (2) the extent of interference with investment-backed expectations; and (3) the character of the governmental action. App. 32a. Applying those factors, the court concluded that the expropriation of Petitioners' property did not violate the Takings Clause because: (1) the expropriation had no economic impact on Petitioners Brown and Hayes since the expropriated interest would not have come into existence but for the IOLTA program and they had not proven that they were affected by the loss of "earnings credits" on the escrow accounts, App. 33a-38a; (2) the expropriation did not interfere with their "investment-backed expectations" since they could not have expected to earn interest on their funds in the absence of IOLTA, App. 38a-39a; and (3) the "character of the government action" could best be "viewed as a regulation of the uses of Brown's and Hayes's property consisting of the principal and the accrued interest in aggregation," not as a confiscation of 100% of the interest income. App. 39a. The court concluded, in light of the highly regulated nature of banking transactions and the ethical obligations of lawyers and LPOs to assist in providing legal services to the indigent, "the IOLTA regulations are not out of character for either the commercial industry or the professions they affect." App. 40a.

Applying the same analysis that led it to conclude that no taking had occurred, the court went on to find, in the alternative, "We . . . hold that even if the IOLTA program

constituted a taking of Brown's and Hayes's private property, there would be no Fifth Amendment violation because the value of their just compensation is nil." App. 45a.

The court recognized that by vacating the district court's holding that Petitioners lacked property rights in the IOLTA interest, it had revived Petitioners' First Amendment claims. Rather than addressing the merits of those claims, the court remanded them for initial consideration in the district court. *Id.*

Judge Kozinski dissented, joined by Judges Trott, Kleinfeld, and Silverman. App. 45a-51a. Judge Kozinski argued that this Court's *Phillips* decision required application of *per se* takings analysis to the expropriation of Petitioners' property; he asserted, "*Penn Central*'s *ad hoc* approach deals with regulatory takings -- a difficult and vexing corner of takings law." App. 48a. He endorsed the panel's conclusion that Respondents' actions constituted a compensable taking of Petitioners' property, stating, "[I]t . . . strikes me as peculiar and quite dangerous to say that the government has greater latitude when it takes money than when it takes other kinds of property." App. 50a.

REASONS FOR GRANTING THE WRIT

This case presents important questions of law concerning the Takings Clause of the Fifth Amendment, questions that have divided the courts of appeals. This Court should grant review of the two questions presented.

First, the decision below conflicts with that of the U.S. Court of Appeals for the Fifth Circuit in *Washington Legal*

Found. v. Texas Equal Access to Justice Found. ["*TEAJF*"], 270 F.3d 180 (5th Cir. 2001), on the issue of whether IOLTA programs effect an unconstitutional taking. In *TEAJF*, the Fifth Circuit had before it a Takings Clause challenge to the Texas IOLTA program, a program identical to the Washington IOLTA program in all relevant respects. The Fifth Circuit resolved the issues in the case in a manner diametrically opposed to the court below, holding that Texas's uncompensated expropriation of client funds in connection with its IOLTA program constituted a *per se* violation of the Takings Clause. *Id.* at 186.

IOLTA programs are now in existence in all 50 States and the District of Columbia. Collectively they raise between $100 million and $150 million each year. Yet although millions of Americans have had their funds expropriated to support IOLTA programs, most are not even aware of IOLTA's existence. The Fifth Circuit's decision striking down the Texas program has now called into question the constitutionality of IOLTA programs throughout the country.

Further, the decision below is demonstrably incorrect under existing decisions of this Court. The court below refuses to take seriously a number of this Court's decisions including *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980); *United States v. Sperry Corp.*, 493 U.S. 52 (1989); and *Phillips v. Washington Legal Found.*, 524 U.S. 156 (1998). Indeed, as the Ninth Circuit's many citations show, it relied not on this Court's decision in *Phillips* but on the dissent from that decision. *See, e.g.*, App. 10a, 32a, 42a.

Grant of certiorari is necessary because the decision of the Ninth Circuit is inconsistent with the teachings of this Court and because it is in direct conflict with the decision of the Fifth Circuit on the constitutionality of IOLTA programs in particular, and more generally on the proper analysis of government programs that confiscate money.

Second, the decision below creates a second, substantial conflict in the circuits by its ruling that prospective injunctive relief is not an appropriate remedy in the event that the IOLTA program results in a Takings Clause violation. This decision is in conflict with the Fifth Circuit's ruling in *TEAJF*, which ordered entry of injunctive relief against IOLTA's continued violations of the Takings Clause. It is also in conflict with decisions of the Second and D.C. Circuits holding that injunctive relief is available in cases where takings result from government action involving direct transfer of money. The Ninth Circuit's narrow view of the availability of injunctive relief is also in conflict with this Court's cases which permit injunctive relief where there is no reasonable, certain, or adequate monetary remedy. The Court should grant certiorari on this issue as well.

I. REVIEW IS WARRANTED TO RESOLVE THE CONFLICT IN THE CIRCUITS OVER WHETHER EXPROPRIATION OF IOLTA FUNDS CONSTITUTES A FIFTH AMENDMENT TAKING

A. The Ninth Circuit's Decision That IOLTA Effects No Unconstitutional Taking Directly Conflicts with the Fifth Circuit's *TEAJF* Decision

The court below held that the Washington IOLTA program's expropriation of Petitioners' property should be examined, for purposes of ruling on Petitioners' Takings Clause claims, using a *Penn Central ad hoc* analysis. App. 27a-32a. The court then determined that that expropriation did not constitute a Fifth Amendment taking and, alternatively, that Petitioners suffered no loss and thus were entitled to no Fifth Amendment compensation. App. 40a, 41a. Each of those rulings is in direct conflict with the Fifth Circuit's *TEAJF* decision, which struck down the nearly identical Texas IOLTA program. The Court should grant review in order to resolve that conflict.

The plaintiffs in *TEAJF* raised a Takings Clause challenge to the Texas IOLTA program that is identical to the challenge raised by Petitioners. Although the Texas IOLTA program applies only to trust funds held by attorneys while the Washington IOLTA program applies to real estate escrow funds as well, that distinction is immaterial to the constitutional analysis. Indeed, the Ninth Circuit repeatedly made clear that it did not distinguish, for purposes of Takings Clause analysis, between IOLTA programs that apply only to attorney trust funds and Washington's more expansive

IOLTA program. *See, e.g.*, App. 25a (*Phillips*'s analysis of Takings Clause issues under the Texas IOLTA program is fully applicable to Petitioners' real estate escrow funds), App. 33a.

Moreover, the Ninth Circuit made no effort to distinguish the Fifth Circuit's *TEAJF* decision on those or any other grounds. The Ninth Circuit explicitly disagreed with *TEAJF*'s conclusion that the Texas IOLTA program was subject to a *per se* takings analysis:

> [G]iven the monetary nature of the property in question, the public nature of the IOLTA program, and the highly regulated nature of the banking industry, we believe that the better approach [than the Fifth Circuit's "*per se* method of analysis"] is that of *Penn Central*.

App. 31a.

The Ninth Circuit's conclusion -- after examining the Washington IOLTA program using a *Penn Central* analysis -- that the program does not constitute a taking, App. 40a-41a, is also in direct conflict with *TEAJF*. Given the Fifth Circuit's conclusion that *per se* takings analysis was applicable, there was no need for it to undertake an explicit *Penn Central* analysis. *See TEAJF*, 270 F.3d at 186-188. Nonetheless, the Fifth Circuit clearly believed that the Texas IOLTA program effected an uncompensated taking of private property regardless whether it was examined using a *per se* or *Penn*

Central analysis, because every *per se* taking would necessarily be a taking if analyzed under *Penn Central*.[6]

---

[6] As the Court explained in *Lucas*, government action generally is deemed a *per se* taking in two situations: (1) where the government confiscates or physically invades private property; or (2) where regulation denies all economically beneficial or productive use of land. *Lucas*, 505 U.S. at 1015. In such cases, "'the character of the government action' not only is an important factor in resolving whether the action works a taking but also is determinative." *Loretto*, 458 U.S. at 426. In other words, there is no need to go through a full-fledged *Penn Central* analysis in such cases; but even if one did so, one would still conclude that the government action effected a Fifth Amendment taking because one of the three principal factors examined in any *Penn Central* analysis (the "character of the government action" factor) would point so strongly in the direction of finding a taking. It follows from the rationale of *Lucas* and *Loretto* that every *per se* taking is also a taking when analyzed under *Penn Central*.

In undertaking its *Penn Central* analysis and addressing the "character of government action," the Ninth Circuit determined that Washington's confiscation of Petitioners' property could best be viewed "as a regulation of the uses of Brown's and Hayes's property, consisting of the principal and interest in aggregation." App. 39a. That peculiar characterization of Washington's actions (deeming confiscation of property to be no more than a form of "regulation") threatens to transform *Penn Central* analysis into the toothless check on government powers that some critics already contend that it is. The Court has expressed an interest in "restor[ing] balance to [the *Penn Central*] inquiry." *Palazzolo v. United States*, 121 S. Ct. 2448, 2467 (2001) (O'Connor, J., concurring). Petitioners submit that, should the Court ultimately determine that IOLTA programs should be examined under the *Penn Central* framework, this case would provide an ideal occasion to restore balance to the *Penn Central* analysis by making clear that government confiscation of property should not be characterized as mere "regulation" of the property.

Finally, the Ninth Circuit's holding that Petitioners suffered no compensable loss (and thus that there was no Fifth Amendment violation even if the IOLTA program constituted a taking of their property) is also in direct conflict with *TEAJF*. The Ninth Circuit based its "no compensable loss" finding on its conclusion that Petitioners were no worse off than if, hypothetically, they had been permitted to keep their funds out of the IOLTA program. App. 44a. In contrast, the Fifth Circuit in *TEAJF* assumed for the sake of argument that the plaintiffs could not have benefitted financially by opting out of the Texas IOLTA Program, *TEAJF*, 270 F.3d at 189 n.10; but it nonetheless concluded both that a Fifth Amendment taking of the plaintiffs' property had occurred and that the taking amounted to a loss that entitled plaintiffs to injunctive and declaratory relief. *Id.* at 189-194.

The defendants in *TEAJF* filed a motion for rehearing *en banc* on October 26, 2001, and the Fifth Circuit has not yet ruled on the motion. Nonetheless, the conflict between the Fifth and Ninth Circuit is not made any less stark by the pendency of that motion. Unless the Court grants review in this case, attorneys and bar authorities across the country will continue to be in a quandary regarding whether IOLTA programs violate the Fifth Amendment.[7] At most, the pendency of the motion for rehearing *en banc* suggests that

[7] Not surprisingly, given the conflicting Fifth and Ninth Circuit decisions, the constitutionality of IOLTA programs has become a hotly debated topic in States throughout the country. For example, a Fifth Amendment challenge to the Massachusetts IOLTA program was recently filed in federal district court in Massachusetts. *See Citizens for the Preservation of Constitutional Rights, Inc. v. Marshall*, No. 02-cv-10125MLW (D. Mass., filed Jan. 23, 2002).

the Court may wish to defer consideration of this Petition until the Fifth Circuit rules on the motion.

B. The Ninth Circuit's Decision That No Taking Occurred Is Inconsistent with the Decisions of This Court

Review is warranted for the additional reason that the Ninth Circuit's decision that no compensable taking occurred is plainly inconsistent with this Court's decisions. The court below was unable to point to a single decision of this Court for the proposition that the government may confiscate private property with a readily ascertainable value and yet not be required to pay compensation to the owners of that property.

The court below viewed as decisive its factual finding that Petitioners could not have derived any financial benefit from opting out of the IOLTA program. That ruling cannot be squared with *Phillips*, which is replete with language indicating that establishing a Takings Clause claim is not dependent on a showing that the plaintiff could benefit by opting out.[8] Although noting that "[w]hether client funds

[8] Indeed, the Question Presented in *Phillips*, as reframed by the Court, stated:

> Is interest earned on client trust funds held by lawyers in IOLTA accounts a property interest of the client or lawyer, cognizable under the Fifth Amendment of the United States Constitution, despite the fundamental precept of IOLTA that such funds, absent the IOLTA program, could *not* earn interest for the client or lawyer.

(continued...)

held in IOLTA accounts could generate net interest is a matter of some dispute," *Phillips* stated that that dispute was not relevant to its determination. *Phillips*, 524 U.S. at 169. The Court explained:

> We have never held that a physical item is not "property" simply because it lacks a positive economic or market value. For example, in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982), we held that a property right was taken even when infringement of that right arguable *increased* the market value of the property at issue. *Id.* at 437 n.15.

Id. at 169-70. If the infringement in *Loretto* was found to be a taking despite evidence that the infringement *increased* the value of the property at issue, then surely Petitioners' takings claims cannot be defeated by a factual finding that they could not have generated net interest on their funds in the absence of the IOLTA program.

The decision below is also inconsistent with *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980), a case whose fact pattern is remarkably similar to *Phillips* and this case. *Webb's* involved interest earned on funds being held in a Florida court registry in connection with an insolvency proceeding. The court deposited the funds in an interest-bearing account and attempted to keep the interest for itself. This Court held that the Florida court violated the Takings Clause by failing to distribute the interest to those later adjudged to have valid claims to the funds in the court

---

[8](...continued)
521 U.S. 1117 (1997) (emphasis added).

registry. *Webb's*, 449 U.S. at 162. *Webb's*' conclusion that Florida's expropriation of money without compensation violated the Takings Clause cannot meaningfully be distinguished from this case. *Webb's* held that the claimants (200 putative creditors of an insolvent company) were entitled to compensation under the Takings Clause for the interest earned on their funds, even though the claimants had no way of earning interest on their own -- as *Webb's* recognized, Florida would have been within its rights to have kept the funds in a non-interest-bearing account and thus earned no interest. *Id.* The court below did not attempt to explain how its decision that no taking had occurred and no compensation was required could be squared with *Webb's*.

In support of its position, the Ninth Circuit relied on *United States v. Sperry Corp.*, 493 U.S. 52 (1989). App. 27a. But as *TEAJF*, the Ninth Circuit panel, and Judge Kozinski's dissent all pointed out, *Sperry* provides no support for the Ninth Circuit's distinction between government confiscation of real and personal property. *TEAJF*, 270 F.3d at 187 (*Sperry* bars application of *per se* analysis only in cases in which the government is imposing a fee for services rendered); App. 49a-50a; App. 74a-75a. Indeed, this Court held in *Phillips* that *Sperry* is inapplicable in Takings Clause cases where, as here, the government does not contend that its confiscation of money is designed to ensure payment for services rendered:

> Our holding does not prohibit a State from imposing reasonable fees it incurs in generating and allocating interest income. *See* [*Webb's*, 449 U.S.] at 162; cf. *United States v. Sperry Corp.*, 493 U.S. 52, 60 (1989) (upholding the imposition of a "reasonable 'user fee'"

> on those utilizing the Iran-United States Claims Tribunal). But here the State does not, indeed cannot, argue that its confiscation of respondents' interest income amounts to a fee for services performed.

Phillips, 524 U.S. at 171.

The Ninth Circuit's holding that Petitioners are not entitled to any compensation for the expropriation of their money is also at odds with numerous decisions of this Court. *See, e.g., Webb's Fabulous Pharmacies v. Beckwith,* 449 U.S. 155, 164 (1980); *United States v. Pewee Coal Co.,* 341 U.S. 114, 118 (1951) (plurality opinion). In support of its holding, the court below cited a series of cases in which this Court has considered how to compute the value of property taken by the government. App. 41a-45a. These cases have held that where the value of the property taken is subject to question (as will often be true of real property), compensation is to be based on the loss suffered by the property owner, not the benefit derived by the government. *See, e.g., Boston Chamber of Commerce v. City of Boston,* 217 U.S. 189, 195 (1910). But that line of cases has no relevance here, where the property taken is money and thus has a readily ascertainable value. In addition, as the Court noted in *Phillips*, "valuable rights . . . inhere in . . . property," and such rights are protected under the Takings Clause even if the owner could not realize income from the exercise of those rights. *Phillips,* 524 U.S. at 170.

In short, the decision below is wrong and is at odds in almost every conceivable way not only with the Fifth Circuit's *TEAJF* decision but also with numerous decisions of this Court. This Court's review is necessary.

II. THIS COURT SHOULD GRANT CERTIORARI TO DETERMINE WHETHER EQUITABLE RELIEF IS AVAILABLE IN CERTAIN TAKINGS CASES

A. There is a Split in the Circuits Over the Availability of Equitable Relief for Governmental Takings that Result From Compelled Transfers of Money

The *en banc* court below held that "prospective injunctive relief is an inappropriate remedy" in this case, and thus that WLF lacked standing to pursue claims for declaratory and injunctive relief. App. 17a-19a.[9] The court held that WLF could not seek to enjoin the IOLTA program on behalf of its members because the only "appropriate relief" was the determination of just compensation, which "necessarily require[d] the participation of the individual members . . . ." App. 19a.

While acknowledging that "equitable relief may be available under other circumstances in a takings case," the Ninth Circuit briskly dismissed the appropriateness of such relief here with the unexplained citation of two cases.[10] The

---

[9] The court similarly found that Petitioners Daugs and Maxwell lack standing because they have no claim for (and are not seeking) monetary relief, the only form of relief (in the court's view) available in Takings Clause claims of this sort. App. 15a-17a.

[10] The citations to this Court's decision in *Duke Power Co. v. Carolina Environmental Study Group*, 438 U.S. 59 (1978) and to *Transohio Sav. Bank v. Director, Office of Thrift Supervision*, 967 F.2d 598 (D.C. Cir. 1992), do not suggest a reason for denying access to

(continued...)

court neither defined the circumstances in which such relief is available nor engaged in any detailed analysis of whether, in this case, compensation would adequately remedy the alleged violation of Fifth Amendment rights. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1016 (1984).

The Ninth Circuit's determination that equitable relief is not an appropriate remedy in this case is in direct conflict with the Fifth Circuit's decision in *TEAJF*. There, in a similar challenge to the Texas IOLTA program, the court held that equitable relief was the most appropriate remedy because "the very purpose of the program would be thwarted" if the program were allowed to continue but then Texas were required to provide compensation. *TEAJF*, 270 F.3d at 194. The Fifth Circuit cited this Court's plurality opinion in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), in support of its conclusion that the plaintiffs could seek equitable relief; it held that Texas could not possibly have intended, if its IOLTA program were later determined to violate the Fifth Amendment, to continue to collect funds that would then immediately be refunded as Takings Clause

---

[10](...continued)
equitable relief here. *Duke Power* involved a challenge to a statute in a case where, as this Court held, declaratory relief was certainly proper given the inadequacy of the statutory damage remedy available. In *Transohio*, the D.C. Circuit held that plaintiffs had no property interest to be "taken" by the government, *id.* at 613, and stated in dicta that "injunctive relief [is available] in the few cases where a Claims Court remedy is so inadequate that the plaintiff would not be justly compensated." *Id.* (quotations omitted). This cursory and opaque treatment of the issue by the Ninth Circuit ignored substantial reasons, apparent from this Court's cases and discussed below, for finding that equitable relief is available in cases such as this one.

compensation: "because the purpose of IOLTA is to take the interest generated from client-funds and use it to fund legal services for the indigent, it is obvious that the program makes no provision for payment of just compensation." *Id.*

The Ninth Circuit's decision also conflicts with the decisions of two other circuits that equitable relief is available in cases where the legislative scheme at issue requires a direct transfer of money. In *In re Chateaugay Corp.*, 53 F.3d 478 (2d Cir. 1995), the Second Circuit held that it had jurisdiction over claims for equitable relief in a challenge to the Coal Industry Retiree Health Benefit Act which required former coal companies to contribute to healthcare plans for retired miners. The court drew a distinction between statutes which burden real or tangible property, and "those requiring direct transfers of money to the government." *Id.* at 493. "We hold that where the challenged statute requires a person or entity to pay money to the government, it must be presumed that Congress had no intention of providing compensation for the deprivation through the Tucker Act. Common sense dictates such a presumption." *Id.*

In *Student Loan Mktg. Ass'n v. Riley*, 104 F.3d 397, 402 (D.C. Cir. 1997), the D.C. Circuit followed the reasoning of *Chateaugay* and held that equitable relief was available "in cases involving straightforward mandates of cash payment to the government." It found that although suits for compensation under the Tucker Act may be an appropriate remedy where the government has taken property, district courts retain equitable jurisdiction to remedy takings involving "'direct transfers of money to the government.'" *Id.* (citations omitted).

Accordingly, there is a split in the Circuits, between the Fifth, Second and D.C. Circuits, on one hand, and the Ninth Circuit, on the other, on whether equitable relief is available for governmental takings involving the direct transfer of money. Given the recurring nature of this issue, this Court should grant certiorari to ensure that citizens of all States enjoy the same remedial rights with regard to governmental takings of money.

B. The Decision Below is Contrary to the Decisions of this Court, Which Recognize the Availability of Equitable Relief in the Absence of a Reasonable, Certain and Adequate Damage Remedy

The decision below is wrong, because it fails to heed this Court's directive that equitable relief is appropriate in takings cases where there is no "reasonable, certain and adequate provision for obtaining compensation" from the government. *Cherokee Nation v. S. Kansas R. Co.*, 135 U.S. 641, 659 (1890). This principle has sometimes led to the denial of any equitable relief where an adequate remedy to secure compensation existed. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1019 (1984); *Presault v. Interstate Commerce Comm.*, 494 U.S. 1, 13 (1990). However, it has also led this Court to make clear that equitable relief is available where compensation is uncertain, inadequate, or entirely unavailable, in view of all of the circumstances.

For example, in *Duke Power Co. v. Carolina Envtl. Study Group*, 438 U.S. 59 (1978), plaintiffs challenged the Price Anderson Act on the grounds that "in the event of a nuclear accident their property would be 'taken' without any

assurance of just compensation." *Id.* at 69. This Court found that it had jurisdiction over claims for declaratory relief brought "before potentially uncompensated damages are sustained" because "the Price-Anderson Act does not provide advance assurance of adequate compensation in the event of a taking . . . ." *Id.* at 71 n.15. Although *Duke Power* clearly presents a dramatic case for equitable relief, this Court has not limited equitable relief to the unique circumstance of potential danger from a nuclear accident.

Like the Second, Fifth, and D.C. Circuits, this Court has also granted equitable relief in cases involving statutory schemes requiring the direct transfer of the property-owners' money. In *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), this Court reviewed a Florida statute which permitted the clerk of the court to retain interest accrued on funds of private persons held in interpleader accounts. Describing its task as the determination of "whether the second exaction by Seminole County amounted to a 'taking' -- it was obviously uncompensated -- within the Amendment's proscription," *id.* at 160, the Court struck the statute down as unconstitutional.[11]

The Court's reasoning in allowing declaratory and/or injunctive relief in takings cases involving monetary transfers

---

[11] Similarly, in *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211 (1985), and *Concrete Pipe and Products v. Constr. Laborers Pension Trust*, 508 U.S. 602 (1993), two cases dealing with contributions mandated by the Multiemployer Pension Plan Amendments Act, the Court appeared to proceed on the premise that equitable relief was available to remedy any taking, when it asserted jurisdiction over the claims for injunctive and declaratory relief. In both cases, the Court ultimately found no unconstitutional taking.

was made explicit by the plurality opinion in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998). Eastern sought a declaratory judgment finding the Coal Act's requirement that certain coal companies fund health plans for retired miners violated the Constitution. The plurality found that equitable relief was available because a suit for compensation was not:

> In cases such as this one, it cannot be said that monetary relief against the Government is an available remedy. . . . Congress could not have contemplated that the Treasury would compensate coal operators for their liability under the Act, for '[e]very dollar paid pursuant to a statute would be presumed to generate a dollar of Tucker Act compensation.' *In re Chateaugay Corp.*, 53 F.3d at 493. . . . In that situation, a claim for compensation 'would entail an utterly pointless set of activities.' *Student Loan Marketing Assn. v. Riley*, 104 F.3d 397, 401 (C.A. D.C. 1997).

Id. at 521. The plurality held that equitable relief was appropriate under the circumstances. *Id.* at 522.

The rationale of *Eastern Enterprises*, under which damages are an inadequate remedy and injunctive relief is appropriate when a government program takes money outright to support governmental objectives, is directly applicable here. The Fifth Circuit was correct in concluding that the IOLTA program "makes no provision for payment of just compensation." *TEAJF*, 270 F.3d at 194. Indeed, "[i]f the interest earned on client-funds were available as just compensation for the clients, the very purpose of the program would be thwarted; therefore, it would defy logic, to say the least, to presume the availability of a just compensation

remedy." *Id.* Equitable relief is thus appropriate in this case where the IOLTA program effects a direct transfer of the property-owners' interest.

No reasonable, certain and adequate compensation remedy exists here for the additional reason that the amount at issue is so minimal as to make a legal action for damages impractical. In that situation, the only effective remedy for such a pattern of governmental conduct is invalidation of the practice in issue. This Court appears to have recognized that fact in *Babbitt v. Youpee*, 519 U.S. 234, 245 (1997), where the Court granted declaratory relief and struck down the Indian Land Consolidation Act, which eliminated the ability of tribe members to pass fractional interests in property upon their deaths, mandating that the fractional interests would pass instead to the tribe. The statute specifically targeted small fractional interests -- those that constituted less than 2% of the total acreage of the parcel and that were incapable of earning more than $100 in a year, *id.* at 240-41 -- and it appears that because these interests were so small, individual tribe members could not practicably sue to recover compensation for the value of the land thus taken. In that circumstance, the Court did not require each member of the tribe to seek compensation; it granted equitable relief to enjoin the takings in the first place.

The same reasoning applies here. Under IOLTA, the government confiscates small amounts of interest -- amounts so small that the costs of litigation will often, if not always, exceed the amount of any individual recovery. In such a case, it is likewise fair to conclude that no damage remedy is practicably available, and equitable relief must be available

to prevent government action amounting to a systematic and deliberate taking.

Other circumstances can be imagined which justify the conclusion that an equitable remedy must be available for a constitutional taking.[12] Contrary to the suggestion of the court below, the range of such situations is neither mysterious nor extraordinarily narrow. It is rather simply those cases in which it can fairly be said, under all the circumstances, that there is no reasonable, certain and adequate compensation remedy available to takings claimants. This Court should grant certiorari to clarify that equitable relief is certainly available on the facts presented here, and thus that all Petitioners should be permitted to go forward with their Fifth Amendment claims.

CONCLUSION

The petition for a writ of certiorari should be granted.

---

[12] For example, a state actor's failure to waive sovereign immunity or immunity from federal court suit under the Eleventh Amendment, may be one such circumstance rendering suits for compensation either unavailable or impractical. In this regard, Petitioners note that Respondents raised the Eleventh Amendment as an affirmative defense in their answer to the complaint, and they have never explicitly waived that defense.

Respectfully submitted,

Charles Fried
1525 Massachusetts Ave.
Cambridge, MA 02138
(617) 495-4636

Donald B. Ayer
Cynthia L. Bauerly
Jones, Day, Reavis & Pogue
51 Louisiana Ave., NW
Washington, DC 20001
(202) 879-3939

Daniel J. Popeo
Richard A. Samp
(Counsel of Record)
Washington Legal Foundation
2009 Massachusetts Ave, NW
Washington, DC 20036
(202) 588-0302

James J. Purcell
1218 3rd Ave., #2403
Seattle, WA 98101
(206) 622-5322

Date: March 7, 2002

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 98-35154

D.C. No. CV-97-00146-JCC

WASHINGTON LEGAL FOUNDATION; ALLEN D. BROWN; DENNIS H. DAUGS; GREG HAYES; L. DIAN MAXWELL,
Plaintiffs-Appellants,

v.

LEGAL FOUNDATION OF WASHINGTON; KEVIN F. KELLY; BARBARA DURHAM, Chief Justice; GERRY L. ALEXANDER, Justice; JAMES M. DOLLIVER, Justice; RICHARD P. GUY, Justice; CHARLES WAYNE JOHNSON, Justice; BARBARA A. MADSEN, Justice; CHARLES Z. SMITH, Justice; PHILIP A. TALMADGE, Justice,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Washington
John C. Coughenour, District Judge Presiding

Rehearing En banc Granted May 9, 2001

Argued and Submitted En Banc
June 21, 2001 -- San Francisco, California

Filed November 14, 2001

Before: Mary M. Schroeder, Chief Judge, Harry Pregerson, Alex Kozinski, Stephen S. Trott, Andrew J. Kleinfeld,

A. Wallace Tashima, Barry G. Silverman,
Kim McLane Wardlaw, Raymond C. Fisher,
Marsha S. Berzon, and Johnnie B. Rawlinson,
Circuit Judges

Opinion by Judge Wardlaw
Dissent by Judge Kozinski

WARDLAW, Circuit Judge:

Four individuals, Allen Brown, Greg Hayes, Dennis Daugs, and Dian Maxwell, and the Washington Legal Foundation (collectively "Appellants") challenge the legality of Washington State's Interest on Lawyers' Trust Account ("IOLTA") program on First and Fifth Amendment grounds. Beginning where the Supreme Court left off in *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 1605 (1998), Appellants contend that the Washington State IOLTA program unconstitutionally takes the interest generated by their monies placed in IOLTA trust accounts and compels speech. We review this case en banc to consider whether there has been an unconstitutional taking, i.e., a taking without just compensation, of property belonging to Appellants. In doing so, we reject the analytical approach that "trifurcates" the Fifth Amendment issues, previously taken of procedural necessity or otherwise by other courts. Believing the better approach to be consideration of the Fifth Amendment question as a whole, we must decide whether the State of Washington, by establishing its IOLTA program and applying it to Limited Practice Officers, took property belonging to any of the five Appellants without providing just compensation therefor. We analyze this issue in accordance with the dictates of *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 124 (1978), and hold that with respect to the funds deposited into client trust

accounts by the Limited Practice Officers in this case, there has been no taking of property without just compensation in violation of the Fifth Amendment. U.S. Const. amend. V. We have jurisdiction pursuant to 28 U.S.C. § 1291, and we affirm the district court with respect to Appellants' Fifth Amendment claim. Because the district court did not have the opportunity to consider Appellants' First Amendment claim in light of *Phillips*, however, we vacate the judgment on that claim and remand for further proceedings.

I. IOLTA

When a lawyer takes the oath of a state bar, he receives the great privilege of admission to the practice of law in that state and pledges to conduct himself in accordance with the code of professional responsibility that accompanies such an honor. Of the many ethical requirements placed upon lawyers, one of the most significant is loyalty to the client. In addition to representing their clients zealously and protecting their legal rights, lawyers must protect the integrity of their clients' property and avoid using their position as the property's temporary guardian to their own benefit. To this end, lawyers have long been required to place their clients' money in bank accounts separate from their own. As early as 1908, professional ethical guidelines required that "money of the client or collected for the client . . . should be reported and accounted for promptly, and should not under any circumstances be commingled with his own or be used by him." Canons of Professional Ethics Canon 11 (1908) (amended 1933). Today, almost one hundred years later, lawyers in all fifty states are held to that same high standard of professional conduct. According to the Model Rules of Professional Conduct, "[a] lawyer shall hold property of clients or third persons that is in a lawyer's possession in

connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person." Model Rules of Prof'l Conduct R. 1.15(a) (1999).

In compliance with these ethical obligations, before 1980, clients' funds were generally pooled in noninterest-bearing, federally insured checking accounts. *Phillips*, 524 U.S. at 160. Even though, at that time, federal law prohibited federally insured banks from paying interest on checking accounts, such accounts were used to ensure that the funds were available on demand. See 12 U.S.C. §§ 371a, 1464(b)(1)(B), 1828(g). The holding bank received a great windfall from these accounts. Not only did the holding banks use the funds as an interest-free loan, keeping all the derived income, but they also charged the account holder -- the lawyer -- a fee for services rendered. Only if a sum was very large or was to be held for a long period of time would it be placed in an interest-bearing savings account, because, at that point, the loss of the checking account convenience was outweighed by the value of the interest gained. *See Phillips*, 524 U.S. at 160-61; *see also* ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 348 (1982). When such an account was set up, the client bore the additional costs for any services rendered by the bank and the lawyer in accounting for the interest, remitting it to the client, and generating tax forms for both the client and the Internal Revenue Service.

Client trust accounts, however, would not remain interest-free for long. In 1980, Congress passed the Consumer Checking Account Equity Act, codified at 12 U.S.C. § 1832, which allowed federally insured banks to pay interest on certain demand accounts, called "Negotiable Order of Withdrawal" ("NOW") accounts. NOW accounts are strictly regulated; they must "consist solely of funds in

which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, political, or other similar purposes and which is not operated for profit." *Phillips*, 524 U.S. at 161 (quoting 12 U.S.C. § 1832(a)(2)). Although for-profit organizations, such as corporations, partnerships, associations, and insurance companies, are precluded from establishing NOW accounts for their own benefit, the Federal Reserve Board has determined that they may do so if the funds "are held in trust pursuant to a program under which charitable organizations have 'the exclusive right to the interest.'" *Id.* at 161 (citation omitted).

Congress could not have better timed its authorization of interest-bearing NOW accounts. Not only had interest rates reached unprecedented levels in the 1970s, but the States were in need of a new source of legal aid funding. An ethical tradition of the legal profession is the provision of legal services to those who cannot afford to pay for them. *See* Model Rules of Prof'l Conduct R. 6.1 (Legal Background); Geoffrey C. Hazard, Jr., *After Professional Virtue*, 6 Sup. Ct. Rev. 213, 215 (1989) ("[A] lawyer's obligation to represent the poor . . . is a classic canon of the legal profession."). Providing legal services to the poor is a complex undertaking, but at a minimum, all attorneys bear the ethical responsibility at some point in their career to represent indigent clients or in some manner work to make the legal system accessible to those who could not otherwise afford it. To that end, bar associations recommend that their members designate a certain number of hours each year to *pro bono* services. *See* Model Rules of Professional Conduct Rule 6.1 (recommending at least fifty hours of pro bono work a year). They also help secure funding to support individuals and organizations that provide indigent legal services. From 1974 to 1981, a large percentage of

this funding came from the Legal Services Corporation, a federally funded corporation, which awarded direct grants to local attorneys providing legal services to the poor. *See* James D. Anderson, *The Future of IOLTA: Solutions to Fifth Amendment Takings Challenges Against IOLTA Programs*, 1999 U. Ill. L. Rev. 717, 720. In 1981, however, Congress severely limited the scope and budget of the Legal Services Corporation, and as a result, the States and their bar associations were forced to look for new sources of funding.

The availability of interest through the establishment of NOW accounts provided a unique opportunity for the legal profession to further two of its most important ethical obligations -- ensuring that all individuals, regardless of their financial circumstances, have access to the judicial system and segregating client trust funds from the lawyers' own accounts -- without imposing additional societal costs. By pooling client deposits that individually were so small or held for such a short period of time that they would not earn a net positive interest, the States could use the interest earned on the combined deposits -- otherwise enjoyed as a windfall by the banks -- to fund indigent legal services at no cost to the owner of the principal. Thus, in 1981, Florida created the first IOLTA program. Today, every state in the nation has followed suit. *See Phillips*, 524 U.S. at 159 n. 1; *see also* Ind. Prof. Conduct R. 1.15(d) (2000) (Indiana, the last state to do so, instituted an IOLTA program after *Phillips* was decided.). IOLTA programs have been a brilliant success: in 1999, they generated $139 million nationwide. *See* Caitlin Liu, *Court Ruling Threatens A Major Funding Source for Legal Aid*, L.A. Times, Jan. 22, 2001 at B3.

The Washington State Supreme Court created its IOLTA program in 1984, codifying it in the Washington Rules of Professional Conduct as Rule 1.14. This rule requires lawyers to place "client funds that are nominal in

amount or expected to be held for a short period of time" in either (i) a pooled interest-bearing trust account, the interest from which is paid to the Washington Legal Foundation, (ii) a separate interest-bearing trust account for a particular client, or (iii) a "pooled interest-bearing trust account with subaccounting that will provide for computation of interest earned by each client's funds and the payment thereof to the client." Wash. Rules of Prof'l Conduct R. 1.14(c)(2). When deciding the type of account to establish, lawyers need not inform their clients or obtain their clients' consent. Instead, lawyers are instructed to consider "only whether the funds to be invested could be utilized to provide a positive net return to the client," taking into account "(i) the amount of interest that the funds would earn during the period they are expected to be deposited; (ii) the cost of establishing and administering the account, including the cost of the lawyer's service and the cost of preparing any tax reports required for interest accruing to a client's benefit; and (iii) the capability of financial institutions to calculate and pay interest to individual clients." Wash. Rules of Prof'l Conduct R. 1.14(c)(3).

As the IOLTA program was being created, the Washington Supreme Court also ordered the incorporation of the Legal Foundation of Washington, a nonprofit charitable organization dedicated to improving the availability and quality of legal representation for the poor. The Legal Foundation of Washington itself does not litigate or educate but accomplishes its mission by distributing funding to different non-profit and educational associations through a grant application process. In 1990, the IOLTA program provided $3.9 million to the Legal Foundation of Washington, and in 1995, it provided $2.7 million.

This appeal challenges one specific aspect of Washington States's IOLTA program: its application to individuals who, during real estate transactions, place money

in the hands of an escrow or title company that employs at least one Limited Practice Officer ("LPO"), a state-licensed nonlawyer who is permitted by the state to "select, prepare, and complete the appropriate legal documents incident to the closing of real estate and personal property transactions . . . ." Wash. Admission to Practice R. 12. The position of "LPO" was created in 1983 in response to a Washington Supreme Court decision holding that laypersons performing those tasks were engaged in the unauthorized practice of law. *See Bennion, Van Camp, Hagan & Ruhl v. Kassler Escrow, Inc.* 635 P.2d 730 (Wash. 1981). Although IOLTA has applied to lawyers since its inception, it did not apply to LPOs until 1995 when the addition of subsection "h" to Admission to Practice Rule 12 and the enactment of Admission to Practice Rule 12.1 (collectively the "IOLTA rules") imposed on LPOs the same requirements that apply to practicing lawyers. Under Rule 12.1, client funds must be placed in an IOLTA account unless (i) the parties to a real estate transaction enter a written agreement requesting an interest-bearing account and "specifying the manner of distribution of accumulated interest to the parties to the transaction;" (ii) the funds are deposited in "a separate interest-bearing trust account for a particular party to a real or personal property closing on which accumulated interest will be paid to that party;" or (iii) the funds are deposited in "a pooled interest-bearing trust account with subaccounting that will provide for computation of interest earned by each party's funds and the payment thereof to the respective party." Wash. Admission to Practice R. 12.1(c)(2).

Although escrow and title companies, like attorneys, use separate client trust funds to hold their clients' deposits, for the purpose of this decision, the similarity stops there. Unlike attorneys, escrow and title companies have never taken advantage of the interest-bearing capabilities of NOW accounts, even though they both used non-interest bearing

checking accounts before NOW accounts were established. Escrow and title companies have not deemed NOW accounts to be realistic options for their client trust funds due to the difficulty and expense attendant to the crediting of the proper amount of interest to each person whose funds have passed through the escrow account. Furthermore, these companies handle transactions on behalf of for-profit corporations for which client funds cannot be legally deposited in NOW accounts. Thus, even if the IOLTA rules did not exist and the principal would generate net interest, escrow and title companies would not establish interest-bearing NOW accounts.

Before the enactment of the IOLTA rules, escrow and title company client trust funds did not earn interest. They did, however, receive benefits from the holding banks in the form of "earnings credits." The credits, which accrued to the company itself, were used to offset bank fees for a variety of services, including accounting services and wire transfers. With the enactment of Rule 12.1, however, many banks -- but not all -- have stopped offering earnings credits to escrow and title companies opening IOLTA accounts. To make up for the loss of earnings credits and the corresponding rise in bank fees, some escrow companies -- but not all -- now charge "IOLTA" fees. As an example of these charges, Appellants provide a sample "settlement statement," which includes an "IOLTA/Accounting fee" of $5.39 charged to both the buyer and the seller.

II. Procedural History

In reaction to the proliferation of IOLTA programs, the Washington Legal Foundation sought individuals who were affected by these programs and, joining them as co-plaintiffs, initiated a number of lawsuits raising a constitutional takings challenge to their validity. It is a

matter of public record that to date, the Washington Legal Foundation has filed suit challenging state IOLTA programs in California, Massachusetts, Texas, and Washington. The first of these cases to reach the Supreme Court was *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998). *Phillips*, however, arrived in a procedurally awkward manner as the Fifth Circuit Court of Appeals had addressed only the question of whether there existed a property right in the interest accruing to client funds deposited in IOLTA accounts. *Wash. Legal Found. v. Texas Equal Access to Justice Found.*, 94 F.3d 996, 1004 (5th Cir. 1996). The Supreme Court similarly limited its review, granting certiorari to determine whether "interest earned on client trust funds held by lawyers in IOLTA accounts [is] a property interest of the client or lawyer . . . ." *Phillips v. Wash. Legal Found.*, 521 U.S. 1117 (1997) (granting *certiorari*). Thus, the Supreme Court considered only that question. It held "that the interest income generated by funds held in IOLTA accounts is the 'private property' of the owner of the principal." *Phillips*, 524 U.S. at 172 ("We express no view as to whether these funds have been 'taken' by the State; nor do we express an opinion as to the amount of 'just compensation.'"). The Court left open the question of whether a taking occurred without just compensation by virtue of the IOLTA program. This "bifurcation" of the Fifth Amendment question was presciently criticized by the dissenting Justices as "skewing the resolution of the taking and compensation issues that will follow." *Id.* at 178 (Souter, J., dissenting).

While *Phillips* progressed through the hierarchy of the federal courts, the Washington Legal Foundation's remaining IOLTA challenges were also making their way through the federal system. In the case before us, the Foundation joined with four individuals -- two LPOs and two LPO clients -- to challenge Washington State's IOLTA program, naming the

Legal Foundation of Washington, its president, and the Justices of the Washington Supreme Court (collectively "Appellees") as defendants. Appellants alleged that Washington's IOLTA program violated their First and Fifth Amendment rights. They sought (i) a judgment requiring the Legal Foundation of Washington "to refund the full amount of interest earned on Plaintiffs Brown's and Hayes's money placed into IOLTA accounts, plus interest;" (ii) a declaratory judgment that Admission to Practice Rules 12(h) and 12.1 are unconstitutional under the First and Fifth Amendments, "insofar as they require LPOs to place certain client funds into IOLTA trust accounts;" (iii) a permanent injunction preventing the Justices of the Washington Supreme Court "from taking any disciplinary action against LPOs who fail to comply with the requirements of . . . Rules 12(h) and 12.1, and from adopting any rules that purport to require LPOs, as a condition for practicing their profession in Washington, to handle client trust funds in a manner designed to ensure that interest on those funds will accrue to anyone not designated by the client;" and (iv) an award of costs and attorney's fees.

The district court, without the benefit of the *Phillips* decision, granted summary judgment to the Legal Foundation of Washington and the Justices on the ground that Appellants did not have a property right to the interest generated on funds held in IOLTA accounts. Without a property right, the district court reasoned, there could be neither a Fifth nor a First Amendment violation. While the case made its way on appeal to us, however, the Supreme Court held in *Phillips* that those individuals, like Appellants Brown and Hayes, who owned the principal placed in IOLTA accounts also owned the interest. A panel of this court was then faced with the task of advancing to the next stage of the Takings Clause analysis: determining whether there was a taking without just compensation. Following the

Supreme Court's lead in dividing the takings analysis into discrete pieces, the now withdrawn panel decision "trifurcated" the takings question into two further issues: whether there was a taking and what compensation was due. Viewing the interest earned on IOLTA funds as an independent entity, separate and distinct from the principal that gave it life, the panel concluded that the IOLTA program resulted in an appropriation of 100% of Appellants' property. *Wash. Legal Found. v. Legal Found. of Wash.*, 236 F.3d 1097, 1100-01 (9th Cir. 2001), *withdrawn*, 248 F.3d 1201 (2001). Overlooking the Supreme Court's traditional view that due to its fungible nature, money -- as opposed to real or personal property -- cannot be physically appropriated, *see United States v. Sperry Corp.*, 493 U.S. 52, 62 n.9 (1989), the panel applied the *per se* takings test announced in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 441 (1982) (holding that a permanent physical occupation of a portion of a roof was a "taking" regardless of the size of the occupation or the economic impact on the owner because it was a physical appropriation). The panel reversed the district court, holding not only that Appellants owned the IOLTA interest under *Phillips*, but also that the IOLTA program effected a *per se* taking that required remand to the district court to determine what "just compensation" was due. *Wash. Legal Found. v. Legal Found. of Wash.*, 236 F.3d at 1097. A majority of the active judges of this court voted in favor of rehearing en banc. We consider the issue anew.

III. Standing

Resolving a Fifth Amendment takings claim requires a fact specific inquiry into what has been taken and what compensation is due. Preliminarily, then, we must determine what property each Appellant has at stake in these proceed-

ings. Because a property right is a prerequisite for advancing to the second stage of the Takings Clause analysis, we cannot allow all five Appellants to proceed simply because one or two have a valid claim to the interest at issue. Mindful that this is not a class action, we must carefully scrutinize each Appellant's interest in and connection to Washington State's IOLTA program. Upon doing so, we find that two of the four individual plaintiffs lack standing to pursue this action. We conclude that only Appellants Brown and Hayes own funds that contribute to the principal placed in an IOLTA account, and that therefore, only they have a property right to the generated interest. Thus, the district court properly dismissed Daug's and Maxwell's claims (albeit, on other grounds). We also hold that the Washington Legal Foundation lacks representational standing to pursue this action.

A. Individual Standing

"Before reaching a decision on the merits, we [are required to] address the standing issue to determine if we have jurisdiction." *Nat'l Wildlife Fed'n v. Adams*, 629 F.2d 587, 593 n. 11 (9th Cir. 1980). "The standing question is whether the plaintiff has 'alleged such a personal stake in the outcome of the controversy' as to warrant his invocation of federal-court jurisdiction and to justify the exercise of the court's remedial powers on his behalf." *Warth v. Seldin*, 422 U.S. 490, 498-99 (1975) (quoting *Baker v. Carr*, 369 U.S. 186, 204 (1962)). There are three requirements for standing: (1) "a plaintiff must have suffered an 'injury in fact' -- an invasion of a legally protected interest which is (a) concrete and particularized and (b) actual or imminent, not 'conjectural' or 'hypothetical;'" (2) "there must be a causal connection between the injury and the conduct complained of -- the injury has to be 'fairly . . . traceable to

the challenged action of the defendant, and not . . . the result of the independent action of some third party not before the court;'" and (3) "it must be 'likely' as opposed to merely 'speculative,' that the injury will be 'redressed by a favorable decision.'" *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992) (citations omitted) (alterations in original). We examine the property interest alleged by each of the individual Appellants in turn.

1. Appellant Brown

Appellant Allen Brown regularly purchases and sells real estate in the State of Washington. He knows of one transaction in which his escrow money was placed in an IOLTA account maintained at the Skagit State Bank. According to Brown, the $90,521.29 that he deposited with Land Title Company was placed in an IOLTA account for two days in April of 1997. He "objects to anyone other than me taking the interest earned on my funds." He also "objects to some of the activities engaged in by LFW and by those to whom LFW distributes IOLTA funds." Because Brown owned the principal that was placed in an IOLTA account, we conclude that the "interest income" earned on that principal is his property and therefore he has standing to challenge the IOLTA program. *See Phillips*, 524 U.S. at 172.

2. Appellant Hayes

Appellant Greg Hayes has purchased real estate in the State of Washington as part of his business dealings and expects to continue to do so. He and his business partner gave $1000 earnest money to Fidelity National Title Company on August 14, 1996, and the remainder of the property's cost, $6,396.66, on August 28, 1996. Fidelity

deposited both sums in an IOLTA account. The real estate transaction closed on August 30, 1996. Hayes was not informed that his escrow funds were being placed in an IOLTA account, and he did not learn of the existence of IOLTA until after that transaction was completed. Like Brown, Hayes "objects to anyone other than me taking the interest earned on my funds" and "to some of the activities engaged in by LFW and by those to whom LFW distributes IOLTA funds." Also like Brown, Hayes owned the principal that was placed in an IOLTA account. Thus, we conclude that the "interest income" earned on that principal is his property. Hayes therefore has standing to pursue this action. *See Phillips*, 524 U.S. at 172.

3. Appellant Daugs

Appellant Dennis Daugs is vice-president of SeaTac Escrow, Inc. ("SeaTac"), which provides escrow services to buyers and sellers in connection with real estate transactions. Daugs is also a licensed LPO, but he refuses to comply with Rule 12.1 because he "ha[s] determined that doing so would violate SeaTac's Fifth Amendment rights (as the holder of legal title to funds in the escrow account) and those of [his] customers (who hold equitable title to the funds)." Under Washington law, however, "legal title" does not include any valuable beneficial interests. *See, e.g., Lee v. Wrixon*, 79 P. 489, 490 (Wash. 1905) ("The bare legal title, . . . uncoupled with a beneficial interest, is not subject to execution."). Thus, assuming, without deciding, that Daugs holds "legal title" to the principal placed in the escrow account, that alone does not confer on him a right of ownership. Although Daugs may have legitimate objections to the IOLTA program and may believe his clients are better served by disregarding its dictates, he does not own the principal that is deposited in the IOLTA accounts, and therefore, he has

no claim to the generated interest. Without the requisite property right, Daugs lacks standing to challenge the IOLTA program on Fifth Amendment grounds. We thus affirm the district court's judgment as to Appellant Daugs.

4. Appellant Maxwell

Appellant Dian Maxwell is employed by Pacific Northwest Title Company of Washington ("PNW"), which provides escrow services among other things. After Rule 12.1 was established, PNW decided that to avoid the additional costs of the IOLTA program, estimated to be about $50.00 per transaction, it would not comply with Rule 12.1. Thus, PNW required its LPOs -- including Maxwell -- to surrender their licenses if they wished to continue employment. According to Maxwell, relinquishing her LPO license prevents her from fully practicing her profession because she can no longer "select and fill in the legal documents that [she is] fully qualified to select and fill in." Unlike Daugs, who asserts in his declaration that he -- as the owner of SeaTac -- held legal title to the principal placed in IOLTA accounts, Maxwell does not claim any ownership in the principal or the generated interest. At most, Maxwell appears to be arguing that she lost property in the form of her LPO license as a result of the IOLTA rules.

Although Maxwell may have been adversely affected by application of the IOLTA rules to LPOs, the loss of her LPO license was an indirect result of PNW's independent decision to eliminate LPOs from its payroll. Even if LPOs were exempt from the IOLTA rules, Maxwell can only speculate as to whether PNW would allow her to obtain a new LPO license while under its employment. Maxwell has failed to establish that her injury -- the loss of her LPO license -- would be redressed if LPOs were no longer required to place client funds in IOLTA accounts because such

a result would require PNW to make an independent, intervening decision to employ licensed LPOs. *See Pritikin v. Dept. of Energy*, 254 F.3d 791, 797 (9th Cir. 2001). Thus, not only was she properly denied relief by the district court on the ground that she had no property right to the generated interest, but because she has not shown that eliminating Rule 12.1 will redress her injury, she lacks standing to challenge the IOLTA program on Fifth Amendment grounds. *See Lujan*, 504 U.S. at 560-61 (1992).

B. Representational Standing

Washington Legal Foundation is a public-interest law and policy center with members nationwide. As evidence of its connection to the Washington IOLTA program, Washington Legal Foundation declares that its membership includes "citizens of Washington who object to having their money used to support the Washington IOLTA program, and LPOs in Washington who object to being forced to place client trust funds in IOLTA accounts." Of the four named Appellants, it appears that only Daugs and Hayes are themselves members.

The Supreme Court has established a three-prong test for determining whether an organization, such as the Washington Legal Foundation, can sue in its representative capacity. *See Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 343 (1977); *Presidio Golf Club v. Nat'l Park Serv.*, 155 F.3d 1153, 1159 (9th Cir. 1998). "An association has standing to bring suit on behalf of its members when: (1) its members would otherwise have standing to sue in their own right; (2) the interests it seeks to protect are germane to the organization's purpose; and (3) neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit." *Hunt*, 432 U.S. at 343. If "the association seeks a declaration, injunc-

tion, or some other form of prospective relief, it can reasonably be supposed that the remedy, if granted, will inure to the benefit of those members of the association actually injured. Indeed, in all cases in which we have expressly recognized standing in associations to represent their members, the relief sought has been of this kind." *Id.* (quoting *Warth*, 422 U.S. at 515).

With respect to the alleged Fifth Amendment violation, Washington Legal Foundation encounters problems at the third prong of the representational standing inquiry. Because "the Fifth Amendment does not proscribe the taking of property; it proscribes taking without just compensation," *Williamson County Reg'l Planning Comm'n v. Hamilton Bank of Johnson City*, 473 U.S. 172, 194 (1985), prospective injunctive relief is an inappropriate remedy here, where the individuals are pursuing their remedy against the state, and the question is whether they are entitled to any remedy for the state regulatory action at issue. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1016 (1984) ("Equitable relief is not available to enjoin an alleged taking of private property for public use, duly authorized by law, when a suit for compensation can be brought against the sovereign subsequent to the taking."). While equitable relief may be available under other circumstances in a takings case, *see, e.g., Duke Power Co. v. Carolina Environmental Study Group. Inc.*, 438 U.S. 59, 71 n.15 (1978) ("[The Declaratory Judgment Act] allows individuals threatened with a taking to seek a declaration of the constitutionality of the disputed governmental action before potentially uncompensable damages are sustained."); *Transohio Sav. Bank v. Director, Office of Thrift Supervision*, 967 F.2d 598, 613 (D.C. Cir. 1992) ("the district court should accept jurisdiction over takings claims for injunctive relief in the few cases where a Claims Court remedy is 'so inadequate that the plaintiff would not be justly compensated'") (citation

omitted), the remedy for the Fifth Amendment violation alleged here is to provide the property owner with just compensation, if a taking has occurred. Because the appropriate relief -- determining what, if any, just compensation is due to the owner of the property taken -- necessarily requires the participation of the individual members, Washington Legal Foundation does not have representational standing to pursue a Fifth Amendment taking claim.

Thus, we hold that only individual Appellants Brown and Hayes have standing. We affirm the district court's grant of summary judgment to the Legal Foundation of Washington and the Justices of the Washington Supreme Court on the Fifth Amendment claims of Daugs, Maxwell, and the Washington Legal Foundation. We leave open the question of standing as it pertains to the Appellants' First Amendment claims. We proceed with our Takings Clause analysis only as it relates to the property of Appellants Brown and Hayes.

IV. Ripeness

Also as a jurisdictional matter, we must determine whether the Fifth Amendment challenges of Brown and Hayes are ripe for review. The ripeness doctrine is derived from Article III's case or controversy requirement. It "prevents 'the courts . . . from entangling themselves in abstract disagreements over administrative policies, and also . . . protect[s] the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by challenging parties.'" *Stuhlbarg Int'l Sales Co. v. John D. Brush and Co.*, 240 F.3d 832, 839 (9th Cir. 2001) (quoting *Lee Pharm. v. Kreps*, 577 F.2d 610, 618 (9th Cir. 1978)) (alterations in original). Although Appellees did not raise the question of ripeness at the district court, we may consider it for the first time on appeal. *See*

Reno v. Catholic Soc. Servs., 509 U.S. 43, 58 n.18 (1993) (concluding that because ripeness is derived in part from Article III principles, it may be raised for first time in the Supreme Court); *In re Cool Fuel Inc.*, 210 F.3d 999, 1006 (9th Cir. 2000) (holding that ripeness claims may be raised for the first time on appeal).

Appellees argue that the Fifth Amendment claims of Brown and Hayes are not ripe for review under *Williamson County Regional Planning Commission v. Hamilton Bank*, 473 U.S. 172 (1985). We disagree.

In *Williamson*, petitioners claimed that the application of particular zoning regulations deprived them of their property without just compensation. Specifically, they alleged that the Williamson regional planning commission unreasonably disapproved of Hamilton Bank's preliminary development plans. *Williamson*, 473 U.S. at 175. Before the Court could reach the merits, however, it first had to determine whether the Commission had reached a final decision with respect to the development plans. If the Commission's decision was not final, it could not have "taken" the property, and the case would not be ripe for review. *Id.* at 186. The Court then established a two-prong test for determining whether the takings claim was ripe. First, "the government entity charged with implementing the regulations [must have] reached a final decision regarding the application of the regulations to the property at issue." *Id.* at 186. Second, compensation must have been sought "through the procedures the State has provided for doing so." *Id.* at 194. Hamilton Bank had not sought building variances to allow development in accordance with its proposed plans, thereby failing to obtain the required final decision, *id.* at 190, nor had it sought compensation through the state's inverse condemnation proceedings, thereby precluding a determination that the State's compensation was

either just or not, *id.* at 194. The Court therefore concluded that the claim was not ripe.

There are, however, a few limited exceptions to the requirement of seeking compensation from the State before raising a takings claim. *Williamson* itself held that a plaintiff may be excused from this requirement if he demonstrates that "the inverse condemnation procedure is unavailable or inadequate." *Id.* at 197. In addition, "an exception exists where the state does not have a 'reasonable, certain, and adequate provision for obtaining compensation' at the time of the taking," *San Remo Hotel v. City and County of San Francisco*, 145 F.3d 1095, 1101-02 (9th Cir. 1998); *see also Levald, Inc. v. City of Palm Desert*, 998 F.2d 680, 687 (9th Cir. 1993), or where resorting to state remedies would be futile, *see City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 710 (1999).

With respect to the first requirement, the enactment of Rules 12(h) and 12.1 constitutes a final decision. With respect to the second, we believe that the futility exception applies. The final authority on a Washington State inverse condemnation proceeding is the Washington Supreme Court. The Justices of the Washington Supreme Court, as parties to the present action, have filed briefs that argue, not just that the claim is unripe, but that there was no Fifth Amendment violation. The Justices do not point to an available state remedy, nor do they suggest that one is needed. Thus, we conclude that requiring Brown and Hayes to seek compensation from the State -- a decision reviewable by the State Supreme Court -- would be futile, and hold that the Fifth Amendment challenges to the IOLTA program raised by Brown and Hayes are ripe for review.

V. The Fifth Amendment

The Fifth Amendment, made applicable to the States through the Fourteenth Amendment, prohibits the taking of "private property . . . for public use, without just compensation." U.S. Const. amend. V. For Brown and Hayes to succeed in their Fifth Amendment challenges, they must establish that the interest at issue was their private property and that it was taken without just compensation. *See Del Monte Dunes at Monterey v. City of Monterey*, 920 F.2d 1496, 1500 (9th Cir. 1990). An allegation that private property for which no compensation is due has been taken is insufficient to sustain a Fifth Amendment claim because it is the taking without just compensation that is constitutionally prohibited. *See Williamson Coun. Reg's Planning Comm'n*, 473 U.S. at 194 ("The Fifth Amendment does not proscribe the taking of property; it proscribes taking without just compensation."); *Macri v. King County*, 126 F.3d 1125, 1129 (9th Cir. 1997) ("The Fifth Amendment is not offended by the government taking property, but only by the government taking property without just compensation.").

A. Private Property

Following the Supreme Court's decision in *Phillips*, there can be no doubt that the interest earned on IOLTA account deposits is the private property of the owners of the principal. Thus, under *Phillips*, Appellants Brown and Hayes have a property right to whatever interest their individual deposits generate.

Appellees nevertheless attempt to distinguish *Phillips*, urging us to hold that, because property rights are created by state law, *Phillips*, which assessed property rights under Texas law, does not control the decision under Washington State law. *See Phillips*, 524 U.S. at 164 (quoting *Bd. of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972)) ("The existence of a property interest is determined

by reference to 'existing rules or understandings that stem from an independent source such as state law.'"). This attempt is unavailing, however, because whatever distinction there may exist between Texas and Washington property law is not a tenable basis for avoiding the rule of *Phillips*.

In reaching its conclusion that "regardless of whether the owner of the principal has a constitutionally cognizable interest in the anticipated generation of interest by his funds, any interest that does accrue attaches as a property right incident to the ownership of the underlying principal," *id.* at 168 (emphasis in original), the *Phillips* majority relied upon "the rule that 'interest follows principal' [that] has been established under English common law since at least the mid-1700's." *Id.* at 165 (quoting *Beckford v. Tobin*, 27 Eng. Rep. 1049, 1051 (Ch. 1749) ("Interest shall follow the principal, as the shadow the body."")). Because Texas courts had long recognized the application of this common law rule, the Court rejected the argument that certain provisions of Texas law -- income-only trusts and marital community property rules -- demonstrated its disavowment. *Id.* at 167-68. Furthermore, allowing Texas to legislatively "sidestep the Takings Clause by disavowing traditional property interests long recognized under state law" would directly contradict the Court's holding in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), that "'a State, by *ipse dixit*, may not transform private property into public property without compensation' simply by legislatively abrogating the traditional rule that 'earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property.'" *Phillips*, 524 U.S. at 167 (citation omitted).

We applied *Webb's* and *Phillips* in *Schneider v. California Department of Corrections*, 151 F.3d 1194 (9th Cir. 1998), which held, despite a state statute to the contrary, that prisoners possess a constitutionally cognizable

property right in the interest earned on the principal held in Inmate Trust Accounts. *Schneider*, 151 F.3d at 1201. Seeking to square *Webb's* and *Phillips*, which held that the common law rule that "interest follows principal" could not be abrogated by state statute, with *Roth*, which held that property interests were protected by the Constitution but created by state law, we distinguished between "new property" interests and "old property" interests. *Id.* at 1200-01. Although *Roth*, "a so-called 'new property' case," affirmed the "unremarkable proposition that state law may affirmatively create constitutionally protected 'new property' interests," it "in no way implied that a State may by statute or regulation roll back or eliminate traditional 'old property' rights." *Id.* at 1200 (emphasis in original).

> The States' power vis-a-vis property thus operates as a one-way ratchet of sorts: States may, under certain circumstances, confer "new property" status on interests located outside the core of constitutionally protected property, but they may not encroach upon traditional "old property" interests found within the core.

Id. at 1200-01 (emphasis in original). We defined the "core of constitutionally protected property . . . by reference to traditional 'background principles' of property law." *Id.* Because of the "common law pedigree and near-universal endorsement by American courts[,]" we concluded that the "interest follows principal" rule lay at the core of property law, and therefore could not be abridged by state statute. *Id.* at 1201 (citation omitted).

Although Appellees attempt to demonstrate that under Washington law, Brown and Hayes have no property right in the IOLTA interest, any distinctions that can be drawn between Washington law and Texas law (*Phillips*), Florida law (*Webb's*), or California law (*Schneider*) are immaterial.

This is particularly true given that Washington adopted the common law, as did most other states, by enacting a "reception statute" that provides that "the common law, so far as it is not inconsistent with the Constitution and laws of the United States, or of the state of Washington, nor incompatible with the institutions and condition of society in this state, shall be the rule of decision in all the courts of this state." Wash. Rev. Code § 4.04.010. Furthermore, Washington state courts have previously applied the common law "interest follows principal" rule. In *Tacoma School District. v. Hedges*, 42 P. 522, 522 (Wash. 1895), the Washington Supreme Court held that "in the absence of any statute upon the subject," the interest and penalties collected upon delinquent taxes should go to the school districts entitled to the principal rather than a general county fund. In 1988, nearly a century later, a Washington appellate court, "looking to the common law" and relying on the "principle that interest on public funds follows the ownership of those funds," held that "penalty and interest would follow the taxes upon which they were assessed." *City of Seattle v. King County*, 762 P.2d 1152, 1155 (Wash. Ct. App. 1988).

Thus, Appellees' attempts to distinguish *Phillips* by pointing to differences between Washington and Texas property law fail. The interest earned on the principal owned by Brown and Hayes held in IOLTA accounts is their private property.

B. Unconstitutional Taking

The *Phillips* majority did not address the question of whether an unconstitutional taking of private property occurred:

> We express no view as to whether these funds have been "taken" by the State; nor do we express an

> opinion as to the amount of "just compensation," if any, due respondents. We leave these issues to be addressed on remand.

Phillips, 524 U.S. at 172 (emphasis added). Far from disregarding the *Phillips* majority, as our dissenting colleagues suggest, we follow its directive in answering these questions on a fully developed record.

1. Whether a Taking has Occurred

Because *Phillips* did not reach the issue of whether a taking occurs when a state program enables otherwise barren principal to earn a net positive interest for the benefit of the poor, we turn to other takings cases involving property of a similar nature for guidance. As a preliminary matter, we must define the exact nature of the property at issue. In determining the existence of the property right, the *Phillips* majority stated that the accrued interest "attaches as a property right incident to the ownership of the underlying principal." *Phillips*, 524 U.S. at 168. Thus, the Court acknowledged that without the principal, there would be no interest and no property right in that interest. Because the latter does not exist without the former, we believe that it is logically sound to analyze the two in combination for purposes of determining whether a taking of property occurred. In a similar analysis of interest accruing on deposited funds, the Court characterized the interest on principal as a "beneficial use of [the owner's] property" or "[a restriction of] the owner's full exploitation of the property," *Webb's*, 449 U.S. at 163, thus suggesting that it did not view the principal and the interest as separate and distinct property interests. Applying the same reasoning, the property that we examine is a combination of the principal, which Appellants argue they have a right to keep from

earning interest accruing to the State, and interest generated thereon, which Appellants argue has been taken from them.

a. *Per se* v. *Ad Hoc* Analysis

We have generally accepted two methods of analysis in takings cases: the *per se* analysis used in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 441 (1982), and the ad hoc analysis used in *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 124 (1978). The per se analysis has not typically been employed outside the context of real property. It is a particularly inapt analysis when the property in question is money. As the Supreme Court has observed, "[i]t is artificial to view deductions of a percentage of a monetary award as physical appropriations of property. Unlike real or personal property, money is fungible." *Sperry Corp.*, 493 U.S. at 62 n.9. The Court reaffirmed this view in *Eastern Enterprises v. Apfel*, 524 U.S. 498, 530 (1998), when it held that although Eastern was required to pay millions of dollars to its employee benefits funds, it "is not, of course, a permanent physical occupation of Eastern's property of the kind that we have viewed as a *per se* taking." *Eastern Enters.*, 524 U.S. at 530. We have endorsed *Sperry*'s conclusion that money differs from physical property in respects significant to takings analysis. Applying *Sperry*'s rationale, we held that an "[o]rdinance [imposing a fee in connection with the issuance of permits for nonresidential development to finance low-income housing] does not, as appellants suggest, constitute a taking *per se*." *Commercial Builders of N. Cal. v. City of Sacramento*, 941 F.2d 872, 875 (9th Cir. 1991). Other circuits have similarly approved of this aspect of *Sperry*. *See Meridian Trust and Safe Deposit Co. v. FDIC*, 62 F.3d 449, 454 (2d Cir. 1995) (*ad hoc* analysis employed to determine whether an assessment

under the Federal Deposit Insurance Act's cross-guarantee provision that rendered Meridian Trust insolvent constituted a taking); *Unity Real Estate Co. v. Hudson*, 178 F.3d 649, 674 (3d. Cir.), *cert. denied*, 528 U.S. 963 (1999) (*ad hoc* analysis employed to determine whether requiring plaintiffs to pay benefits under the Coal Industry Retiree Health Benefit Act constituted an unconstitutional taking where it would bankrupt the company because "the categorical approach [to Takings Clause claims] has only been used in real property cases" and states traditionally have a high degree of control over commercial dealings); *Branch v. United States*, 69 F.3d 1571, 1576 (Fed. Cir. 1995) (*ad hoc* analysis employed to determine whether an assessment under the Federal Deposit Insurance Act's cross-guarantee provision constituted a taking because "the challenged assessment did not constitute either an invasion or a restriction on the use of real property"); *Nixon v. United States*, 978 F.2d 1269, 1285 (D.C. Cir. 1992) (characterizing *Sperry* as "distinguishing between money, which is not subject to the *per se* doctrine because it is fungible, and 'real or personal property'" (citation omitted)).

When similarly faced with the question whether a policy that transferred the interest that accrued on interpleader funds deposited in Florida courts to the clerk of the court was an unconstitutional taking in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 163-64 (1980), the Supreme Court used the *ad hoc* analysis of *Penn Central Transportation Co. v. New York*, 438 U.S. 104 (1978), as opposed to *Loretto's per se* approach. Although in the past it had "been permissive in upholding governmental action that may deny the property owner of some beneficial use of his property or that may restrict the owner's full exploitation of the property, if such public action is justified as promoting the general welfare," the Court concluded that Florida's policy had done more than "adjust []the benefits

and burdens of economic life to promote the common good." *Webb's Fabulous Pharm., Inc.*, 449 U.S. at 163 (citation and quotation marks omitted). The Court characterized the Florida policy of retaining the interest from interpleader accounts -- the interest at issue exceeded $90,000 -- as a "forced contribution to general governmental revenues" for which "no police power justification is offered." *Id.* The Court compared the county's appropriation of interest to that addressed in *United States v. Causby*, 328 U.S. 256, 262-63 n.7 (1946), in which the Government had appropriated the air space above claimant's land as part of the flight pattern for military aircraft, destroying its use as a chicken farm. The Supreme Court later categorized Causby as an *ad hoc* case, when it reviewed the factors that had a particular significance on the "essentially *ad hoc*, factual inquiries" in the Court's Takings Clause jurisprudence in *Penn Central*, 438 U.S. at 123-28.

Our conclusion that we should take guidance from the Court's analysis in *Webb's* is bolstered by the Supreme Court's reliance on the *Webb's* decision in *Phillips* when it determined that a property right existed in the first place. Both cases applied the same common law rule -- "any interest . . . follows the principal" -- in concluding that the interest at issue was the property of the owner of the principal. *Phillips*, 524 U.S. at 166.

Moreover, we are presented with the very circumstances for which the *Penn Central* analysis was intended. Here, the government's "interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good." *Penn Central*, 438 U.S. at 124. In creating its IOLTA program, Washington State concluded that "'the health, safety, morals, or general welfare' would be promoted," *see Penn Central*, 438 U.S. at 125 (citation omitted), by using the interest generated on IOLTA funds to help fund legal services for

the poor. Although the IOLTA program, like most government regulations, "curtails some potential for the use or economic exploitation of private property[,] requiring compensation in all such circumstances would effectively compel the government to regulate by purchase." *Andrus v. Allard*, 444 U.S. 51, 65 (1979) (emphasis in original) (applying *Penn Central's ad hoc* analysis to determine if regulations restricting one means of disposing of certain Indian artifacts was an unconstitutional taking). We do not believe that the Fifth Amendment demands such an extreme result. The Takings Clause was never intended to replace the role of the people in determining which social programs are appropriate, and "has not been understood to be a substantive or absolute limit on the government's power to act. That Clause operates as a conditional limitation, permitting the government to do what it wants so long as it pays the charge." *Eastern Enters.*, 524 U.S. at 545 (Kennedy, J., concurring in judgment and dissenting in part).

That the banking industry is the regulatory backdrop for our decision also counsels against the application of the *per se* analysis to the regulations of the use of money at issue. Such analysis has almost exclusively been employed in situations involving real property. In creating its IOLTA program, Washington has not encroached upon a domain devoid of governmental regulation. As the *Phillips* majority recognized, it is the Federal Government's own regulations that make the state IOLTA programs feasible. Specifically, "the Federal Government imposes tax reporting costs only on those who attempt to exercise control over the interest their funds generate, see Rev. Rul. 81-209, 1981-2 Cum. Bull. 16 [and] prohibits for-profit corporations from holding funds in NOW accounts if the interest is paid to the corporation, but permits corporate funds to be held in NOW accounts if the interest is paid to the [IOLTA fund], *see*

Federal Reserve's IOLTA letter." *Phillips*, 524 U.S. at 170-71. We agree with the reasoning of the Federal Circuit:

> Because of "the State's traditionally high degree of control of commercial dealings," *Lucas*, 112 S. Ct. at 2899, the principles of takings law that apply to real property do not apply in the same manner to statutes imposing monetary liability. Thus, even though taxes or special municipal assessments indisputably "take" money from individuals or businesses, assessments of that kind are not treated as *per se* takings under the Fifth Amendment.

Branch, 69 F.3d at 1576 (citations omitted). Given the highly-regulated nature of the banking industry, individuals should expect that their commercial transactions, including their bank deposits, will be regulated. In contrast, "property law has long protected an owner's expectations that he will be relatively undisturbed at least in the possession of his property." *Loretto*, 458 U.S. at 436. While requiring an apartment owner to allow the "direct physical attachment of plates, boxes, wires, bolts, and screws to the building" is directly contrary to the history and tradition of property law, regulating what a bank depositor may earn on a particular bank deposit is concordant with the history and tradition of banking practice. *Id.* at 420.

Although we note that the Fifth Circuit recently has decided in a two to one decision to adopt the *per se* method of analysis in similar (but not identical) circumstances, *see Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, No. 00-50139, 2001 WL 122105 (5th Cir. Oct. 15, 2001), given the monetary nature of the property in question, the public nature of the IOLTA program, and the highly-regulated nature of the banking industry, we believe that the better approach is that of *Penn Central*.

Through the IOLTA program, the State of Washington may properly adjust the rights of individuals for the benefit of the public as long as its actions are "reasonably necessary to the effectuation of a substantial public purpose," *Penn Central*, 438 U.S. at 127, a determination that can be made only by engaging in the fact-specific *ad hoc* analysis. Following the Supreme Court's lead in *Webb's*, and the dictates of well-established takings jurisprudence, we not only believe it is entirely appropriate to apply *Penn Central's ad hoc* takings analysis to the IOLTA program, but that such an analysis is compelled.

b. Application of Ad Hoc Analysis

In conducting the factual inquiry required by *Penn Central*'s *ad hoc* analysis, we may conclude a taking has occurred only if a particular regulation goes so far that it "forces 'some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.'" *Wash. Legal Found. v. Mass. Bar Found.*, 993 F.2d at 974 (quoting *Armstrong v. United States*, 364 U.S. 40, 49 (1960)). Although the *ad hoc* analysis provides no "'set formula' for determining when 'justice and fairness' require that economic injuries caused by public action be compensated by the government, rather than remain disproportionately concentrated on a few persons," the Supreme Court has principally relied on three factors: (1) "the economic impact of the regulation on the claimant;" (2) "the extent to which the regulation has interfered with distinct investment-backed expectations;" and (3) "the character of the governmental action." *Penn Central*, 438 U.S. at 124; *Phillips*, 524 U.S. at 176 ("Attention should be paid to the nature of the government's action, its economic impact, and the degree of any interference with reasonable investment-backed expectations") (Souter, J., dissenting) (citation

omitted). Although we proceed to consider these factors in the context of the LPO-deposited funds here at issue, the *Penn Central* analysis -- as opposed to the *per se* analysis -- applies with the same force of logic to lawyer-deposited client funds.

(i) Economic Impact

Before Rule 12.1 was enacted, escrow and title companies deposited customer trust funds into non-interest bearing checking accounts despite Congress's authorization of interest-bearing NOW accounts in 1980. Even today, those escrow and title companies that do not employ LPOs generally do not use NOW accounts because of the expense and difficulty involved in crediting the proper amount of interest to each affected person and because many of these clients are for-profit organizations prohibited from using NOW accounts. Thus, because no interest would be earned on client funds deposited by escrow and title companies absent the IOLTA program, requiring those companies to place client trust funds in IOLTA accounts has no economic impact on the owners of the principal. Indeed, if there be any economic impact, it is a positive one. Before their enactment, client trust funds were not placed in interest-bearing trust accounts. Following their enactment, however, client trust funds must be placed in interest-bearing accounts if they are not placed in IOLTA accounts. Thus, the IOLTA program, at worst, maintains the status quo and, at best, provides clients with interest they otherwise would not have earned.

Furthermore, the IOLTA regulations themselves provide that only those funds that would not earn a net interest -- either on their own or when pooled with subaccounting -- are to be deposited in IOLTA accounts. If for some reason, funds are placed in an IOLTA account which, due to miscal-

culation on the part of the LPO or some unforeseen delay, could have earned a net positive interest, the "taking" of that generated interest would be the direct result of the LPO's violation of the Admission to Practice Rules. Because such a violation cannot be attributable to the State, it cannot implicate the Takings Clause. Although Appellant Hayes believes that his "choice to receive the interest from my withholdings" was taken and Appellant Brown objects to "having no control over where the interest" goes, absent the IOLTA program, neither would have earned a positive net interest to receive or control. Brown concedes this fact. In response to being asked whether he was arguing that without IOLTA he would have earned $4.96, the amount calculated as the interest earned on the deposit at issue, Brown acknowledged that "without IOLTA in place I may not have earned anything." Thus, because neither Brown nor Hayes would have earned net interest on their principal deposits, placing their funds in IOLTA accounts had no direct economic impact on them.

Nonetheless, Brown and Hayes maintain that they suffered a direct economic impact because, once escrow and title companies employing LPOs were required to place client funds in interest bearing IOLTA accounts, some banks decided to stop offering earnings credits due to the cost of simultaneously paying interest on IOLTA accounts and providing earnings credits. Brown and Hayes claim that, because some escrow and title companies charge IOLTA fees to make up for the lost earnings credits, the cost of their real estate transactions increased. This assertion does not affect our economic impact analysis, for two reasons. First, neither Brown nor Hayes has established either that they were charged an IOLTA fee or that the banks used by their escrow companies have stopped offering earnings credits. Second, the earnings credits were incentive

payments to the escrow companies, not their customers, and, as such, the indirect economic impact on the escrow company customers of the companies' loss of credits cannot be considered as part of a takings analysis.

To the contrary, Skagit Bank, the bank holding Brown's principal, is among those that continue to give earnings credits for IOLTA accounts. Brown, however, argues that "it's on a really reduced scale since IOLTA came into effect." Thus, Brown claims that although he would not receive a direct payment of interest without IOLTA, he lost the equivalent, which "would have been earned in the sense of earnings credits" and have kept his costs down. He, however, fails to establish how much the additional costs were or whether they even existed.

Hayes's principal was deposited in an IOLTA account, Fidelity National Title Company of Washington ("Fidelity"), held with Seafirst Bank. Although Seafirst stopped offering earnings credits on IOLTA accounts some time after Rule 12.1 was adopted, the record does not allow us to determine whether Fidelity passed the loss of earnings credits onto its customers by imposing an IOLTA fee. Hayes's escrow closing statement does not appear to include an IOLTA fee, and Hayes does not assert that such a fee was charged. As support for his claim, Hayes relies solely on his unsupported belief that "escrow companies in order to close the property . . . have to increase their fees and I have to pay them an increased fee to cover the cost of IOLTA."

The record also fails to establish whether, as a general matter, those escrow companies that deal with banks that have stopped giving earnings credits in fact charge an additional fee to cover the loss. It seems, for example, that Daugs's company does not impose additional costs to make up for the loss of earnings credits. On the other hand, Maxwell testified that Pacific Northwest Title Company charged a flat rate "trust accounting fee" after the enactment

of Rule 12.1 during the time that it still employed LPOs. Attached to the declaration of Gerald Wheeler, a C.P.A. who does computerized escrow accounting for banks, is an escrow settlement statement from an unrelated land transaction. Both the buyer and the seller were charged $5.40 as an "IOLTA/Accounting Fee "and a tax on the IOLTA/Accounting Fee. Yet Keith Leffler, an associate professor of Economics at the University of Washington, argues that IOLTA fees are really an example of sellers "testing whether they can profitably raise prices." According to Leffler, "it is very likely that the IOLTA program has had no effect on the prices paid by the users of escrow services." He believes that only an economic analysis could determine whether IOLTA has had an adverse impact on escrow fees, but no such analysis has been done. Furthermore, because those companies that impose IOLTA fees charge both the buyer and seller, Leffler argues that "the amount bears no relationship to any change in earnings credits from . . . earnest money deposits . . . . Even if one could show that as a result of [a loss of earning credits] there was an average increase in the prices paid by users of these services, there would be no reason to believe that the impact on any particular client would bear any relationship to any loss of earnings credit on the funds of that client, much less any relationship to the interest paid to the IOLTA program on that client's funds."

Moreover, as Professor Leffler's economic analysis demonstrates, even if there were an economic impact on escrow companies' customers such as Brown and Hayes, that impact would have been the result of discrete, discretionary pricing decisions by the affected escrow companies in response to the bank's decision to discontinue or decrease the availability of discounts on the companies' banking charges. While the dissent focuses on the fact that the payment of the earnings credits demonstrates that the

deposits had economic value to the bank, one hardly needs that evidence to understand that the entire basis for the profitability of the banking industry is the value to the bank of the temporary use of other people's money. Much more important for present purposes is the recognition that under the commercial arrangement between the escrow companies, the banks, and the escrow companies' customers as it existed before IOLTA, the value of that use was split between the banks and the escrow companies. The customers had no property interest in that value, and, although the escrow companies could choose to pass on the lower overhead resulting from their lower banking costs to their customers, that pricing decision did not create any property interest in the earnings credits. It is true, of course, that because of the IOLTA program the value to the bank of the temporary use of the escrow funds is less (although not zero -- banks do not distribute as interest the full value of deposited money, or they would have no earnings). But that does not change the fact that the earnings credits were nothing but incentive payments to repeat customers, the escrow companies, to use one bank rather than another, and were never the property of the escrow companies' customers.

Because the earnings credits did not belong to the customers in the first place, but rather were incentives provided to the escrow companies to use as they pleased for any covered banking charges, any impact on the customers is no different than many caused by economic regulation of someone else. Any price increase to customers due to increased banking costs would be just the indirect result of a decrease over time in the escrow companies' ability to acquire a certain kind of property for themselves. Moreover, any price increase would be the direct result of a private, discretionary pricing decision in no way mandated by the government. As such, those price increases should no more count as part of a takings analysis regarding the

customers' property than any other economic decision adverse to customers a retailer makes because of the economic impact on it of regulatory changes affecting one of its suppliers. Assume, for example, that changes in banking regulations meant that a supermarket would have to pay higher fees when depositing its daily sales receipts, and consequently the supermarket raised the price of milk. Neither past nor future purchasers of milk, we presume, could validly claim that the price increase was a taking of their property by the government.

Neither Brown nor Hayes can show that the cost of their individual real estate transactions increased as a result of the IOLTA rules. Therefore, we conclude that the alleged loss of the escrow and title companies' earnings credits had no economic impact on them.

(ii) Interference with Distinct Investment-Backed Expectations

"Governmental action through regulation of the use of private property does not cause a taking unless the interference is significant." *Wash. Legal Found. v. Mass. Bar Found.*, 993 F.2d at 976 (citing *Andrus*, 444 U.S. at 66-67). Under Washington State's IOLTA rules, by definition, Appellants Hayes's and Brown's funds would not have been placed in an IOLTA account if they were capable of generating a net interest either on their own or in a "pooled interest-bearing trust account with subaccounting that will provide for computation of interest earned by each client's funds and the payment thereof to the respective party." Wash. Admission to Practice R. 12.1(c)(2). Brown recognized that fact when he testified that "without IOLTA in place I may not have earned anything." Furthermore, because escrow and land title companies, as a general practice, never placed client trust funds in interest-bearing

NOW accounts, neither Brown nor Hayes could have expected their funds to have earned interest while in the hands of their respective escrow and title companies.

Due to the structure of the IOLTA program and the general practices of escrow and title companies, neither Brown nor Hayes could have expected his principal to earn a net interest, and thus, the IOLTA program could not have interfered with their investment-backed expectations.

(iii) Character of Government Action

Brown and Hayes concede that they would have no interest without IOLTA, but they argue that, once interest is created, they have the right to determine what -- if anything -- is done with the interest. Viewing the accrued interest as its own entity, divorced from the principal, for the purpose of characterizing the extent of the "property" taken, Brown and Hayes assert that because the IOLTA rules dictate that all the interest earned on IOLTA accounts must go to the Legal Foundation of Washington, the IOLTA program is the equivalent of a 100 percent physical invasion of their property. We disagree.

The IOLTA rules are better viewed as a regulation of the uses of Brown's and Hayes's property, consisting of the principal and the accrued interest in aggregation. That said, the character of the government action is best viewed in the context of the industry it regulates. Banking is a heavily regulated industry, and the ability of particular types of deposits to earn interest has often been the subject of banking regulations. In fact, without the Federal Government's regulations regarding what types of accounts can earn interest, the IOLTA program may never have been born. Moreover, the ability to practice a profession -- and the conduct expected of those who do -- is also heavily regulated. Lawyers have always been held to the highest

legal and ethical standards. As part of their state bar membership, lawyers in Washington are encouraged to provide legal services "to persons of limited means or to public service or charitable groups." Wash. Rules of Prof'l Conduct R. 6.1. With or without IOLTA, they are required to segregate their clients' funds from their own to ensure that funds are not used improperly. Wash. Rules of Prof'l Conduct R. 1.14. When LPOs are admitted to perform a limited practice of law, they are held to the same legal and ethical standards as lawyers. Thus, they, too, are expected to safeguard their clients' property and to do their best to ensure that the legal system is available to all who need it. Viewed in this context, the IOLTA regulations are not out of character for either the commercial industry or the professions they affect.

The Takings Clause does not prevent the Government from being able to regulate how people use their property but limits that ability to what is "just and fair." *Andrus*, 444 U.S. at 66-67. Although "the government may impose regulations to adjust rights and economic interests among people for the public good," it may "not force 'some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.'" *Wash. Legal Found. v. Mass. Bar Found.*, 993 F.2d at 974 (citation omitted). Here, neither Brown nor Hayes is being singled out to bear a burden that should be borne by the public as a whole. They, as participants in our legal system, are required to place their money in IOLTA trust accounts that generate funds at no cost to them and that expand access to the legal system from which they benefit. Given the highly regulated nature of the banking and professional industries the IOLTA rules affect, this additional unobtrusive regulation does not exceed what is "just and fair" -- especially where Brown and Hayes would have earned no interest absent IOLTA. We therefore conclude that Washington

State's IOLTA program does not take either Brown's or Hayes's property.

2. Just Compensation

There is a second reason why Washington State's IOLTA program does not work a constitutional violation with regard to Brown's and Hayes's property: Even if their property was taken, the Fifth Amendment only protects against a taking without just compensation. Because of the way the IOLTA program operates, the compensation due Brown and Hayes for any taking of their property would be nil. There was therefore no constitutional violation when they were not compensated.

Determining what constitutes "just compensation" requires putting "the owner of the condemned property 'in as good a position pecuniarily as if the property had not been taken.'" *United States v. 564.54 Acres of Land*, 441 U.S. 506, 510 (1979) (quoting *Olson v. United States*, 292 U.S. 246, 255 (1934)). Incidental losses that result from the takings are not compensable. *Winn v. United States*, 272 F.2d 282, 286 (9th Cir. 1959) (rejecting claim that compensation for the loss of business resulting from highway construction should be included in compensation accounting for value of the lost land itself). "The question is, What has the owner lost? not, What has the taker gained?" *Boston Chamber of Commerce v. City of Boston*, 217 U.S. 189, 195 (1910). Thus, we must determine what Brown and Hayes would have enjoyed in the absence of IOLTA.

Land Title Company deposited Brown's money -- $90,521.29 -- into an IOLTA account at Skagit State Bank where it remained for two days. The escrow IOLTA account was earning 1 percent per annuum. Hayes's $14,793.32 was deposited in Fidelity's IOLTA account; $2,000 remained in the IOLTA account for sixteen days and

$12,793.32 remained in the account for two days. It is unclear from the record what the interest rate was at Hayes's bank. As previously discussed, however, without IOLTA, neither Brown nor Hayes would have earned interest on his principal because by regulatory definition, their funds would have not otherwise been placed in an IOLTA account, and the general practice of escrow and title companies was -- and still is -- to place funds in noninterest-bearing accounts when IOLTA does not apply. Although without IOLTA, Brown and Hayes at most would have had the right to keep the principal from earning interest, the loss of that right has no economic value.

In seeking compensation for the interest their principal earned when deposited in the IOLTA account, Brown and Hayes are in actuality seeking compensation for the value added to their property by Washington's IOLTA program. In other words, Brown and Hayes are seeking compensation not for the value of what they lost, but for the value of what the Legal Foundation of Washington has created. Our Takings Clause jurisprudence has never "forced a State to confer, upon the owner of property that cannot produce anything of value for him, ownership of the fruits of that property should that property be rendered fertile through the government's lawful intervention." *Phillips*, 524 U.S. at 181 (Breyer J., dissenting).

In the context of real property, it is clear that the owner of condemned land need not be compensated for the value created by the government's exercise of the power of eminent domain. In *United States v. Virginia Electric and Power Co.*, 365 U.S. 624 (1961) ("*VEPCO*"), for example, the Court had to determine what compensation was due to the owner of a destroyed perpetual and exclusive flowage easement when the Government, exercising its dominant servitude, "reduced the value of riparian lands by denying the riparian owner access to the stream." *Id.* at 629.

Without the overriding dominant servitude, "the Government's destruction of that easement would ordinarily constitute a taking of property within the meaning of the Fifth Amendment." *VEPCO*, 365 U.S. at 627. Guided by the principle that the property interest owner "is entitled to be put in as good a position pecuniarily as if his property had not been taken" but not more, *id.* at 633 (citation omitted), the Court excluded from consideration any value derived from the land's riparian location and the water power development. *Id.* at 629. Because the Government's dominant servitude allowed it to reduce the value of the riparian lands by denying the riparian owner access to the water," it also permitted the Government to disregard the value arising from this same fact of riparian location in compensating the owner when fast lands are appropriated." *Id.* Thus, excluding land's riparian-based value, the Court determined that just compensation for "the value of the easement is the nonriparian value of the servient land discounted by the improbability of the easement's exercise." *Id.* at 635.

It is also clear that a property owner need not be compensated for losing the ability to use his land when there is no "reasonable probability" that such a use will occur. *United States ex rel. Tenn. Valley Auth. v. Powelson*, 319 U.S. 266, 275 (1943). Thus, when the owner of a condemned parcel of land has been granted the power to take, by eminent domain, riparian lands and water rights to set up a system of hydro-electric power production but has not yet used it, the Government need not compensate him for the lost opportunity. *Id.* at 285. Although the value of the condemned property may "reflect not only the use to which the property is presently devoted but also that use to which it may be readily converted," *id.* at 275, it need not reflect "the existence of [a] privilege to use the power of eminent domain" to create a profitable four-dam enterprise in the

distant future. *Id.* at 280. And although the owner of the property was losing a valuable opportunity, "he was not being deprived of values which result from his expenditures or activities." *Id.*

Furthermore, the Government need not compensate "for any part of what it has added to the land." *City of New York v. Sage*, 239 U.S. 57, 61 (1915). Thus, the owner of land condemned for a reservoir is not entitled to compensation for the value added to the land by the availability and adaptability of the reservoir; it need only compensate the owner of the land for what is fairly believed to be the fair market value of the land at the time of condemnation. *Sage*, 239 U.S. at 61. "The Government cannot . . . 'be made to pay for a loss of theoretical creation, suffered by no one in fact,' for there is 'no justice in (requiring the Government to pay) for a loss suffered by no one in fact.'" *VEPCO*, 365 U.S. at 642 (Whittaker, J. dissenting) (citations omitted).

Here, Brown and Hayes admit that, at most, IOLTA takes their right to let their principal lie fallow. In other words, they have lost the opportunity to place the principal in a noninterest-bearing checking account. Once Brown and Hayes gave dominion and control to their respective title and escrow companies, however, their 'right' to control how the principal was used had the same value to them as the barren flowage easement would have had in *VEPCO*, *i.e.*, no value at all. They have produced no evidence that, without IOLTA, they could have dictated how the escrow and title companies handled their principal. Nor have they been deprived of values resulting from their expenditures or activities because, within the restrictions of the IOLTA rules, no such values could exist. Furthermore, while Brown and Hayes have the right to control the accrued interest in theory, as a practical matter, that right will never come to fruition on its own because without IOLTA there is no interest. Thus, although Brown and Hayes may have, at most, lost one of the sticks in their bundle of property rights -- the right to let the principal lie fallow -- "there are numerous business losses which result from condemnation of properties but which are not compensable under the Fifth Amendment." *United States ex rel Tenn. Valley Auth.*, 319 U.S. at 281. This is one of them.

We therefore hold that even if the IOLTA program constituted a taking of Brown's and Hayes's private property, there would be no Fifth Amendment violation because the value of their just compensation is nil.

VI. First Amendment

The district court did not address Appellants' First Amendment claims because it concluded that Appellants did not have a property right to the interest at issue. Because this conclusion was abrogated by *Phillips*, the district court must now consider what speech, if any, is at issue and whether the IOLTA program violates any rights Appellants may have emanating from the First Amendment. Therefore, we vacate this judgment and remand Appellants' First Amendment claims to the district court for further proceedings consistent with this opinion.

VII. Conclusion

For the foregoing reasons, the district court's grant of summary judgment with respect to Appellants' Fifth Amendment claims is affirmed, and its grant of summary judgment with respect to Appellants' First Amendment claims is vacated and remanded. Each party shall bear its own costs of appeal.

AFFIRMED in part, VACATED in part, and REMANDED.

KOZINSKI, Circuit Judge, with whom Judges Trott, Kleinfeld and Silverman join, dissenting.

For the second time within a year, our court follows the dissenters in a Supreme Court takings case while ignoring the Supreme Court majority. *See also Tahoe-Sierra Pres. Council, Inc. v. Tahoe Rental Planning Auth.*, 228 F.3d 998 (9th Cir. 2000) (Kozinski, J., dissenting from denial of rehearing en banc). In so doing, our court once again deprecates one of the cherished protections of the Bill of Rights--the right not to have the government take private property without just compensation. It also creates a square conflict with the only other circuit to have ruled on this issue. *See Wash. Legal Found. v. Tex. Equal Access to Justice Found.*, No. 00-50139, 2001 WL 1222105 (5th Cir. Oct. 15, 2001).

The majority starts--as it must--with the proposition that interest earned by appellants on funds deposited in IOLTA accounts is their property. The reason they must is that the Supreme Court said so. *See Phillips v. Wash. Legal Found.*, 524 U.S. 156 (1998). The question presented, then, is whether the government must pay compensation when it takes this private property for a public purpose. The majority starts down the wrong track by asserting, as if it were an established fact, that there are some kinds of private property the government may take without paying compensation: "An allegation that private property for which no compensation is due has been taken is insufficient to sustain a Fifth Amendment claim because it is the taking without just compensation that is constitutionally prohibited." Maj. Op. at 15663 (emphasis added). But, before today, no case has ever held that there are some kinds of "private property for which no compensation is due." The cases the majority cites stand for a much different proposition: They hold that the Fifth Amendment does not prohibit the taking

of property, as it clearly does not; what it prohibits is the taking of property without compensation. This does not support the majority's claim that there are certain kinds of property the government may take without paying compensation.

The only case authority that arguably supports the majority's radical proposition is Justice Breyer's dissent in *Phillips*. The majority's theory, evidently built upon Justice Breyer's approach, seems to be that if the property owner would not have realized the value of the property but for the government's actions, then the government can take it and pay the owner nothing. Compare Maj. Op. at 15673-75 with *Phillips*, 524 U.S. at 182 (Breyer, J., dissenting). Although Justice Breyer was in distinguished company in *Phillips*, his opinion lacked one important ingredient: a fifth vote. By contrast, the majority in *Phillips* made it quite clear that economic value is not the only interest protected by the just compensation clause: "While the interest income at issue here may have no economically realizable value to its owner, possession, control, and disposition are nonetheless valuable rights that inhere in the property." *Phillips*, 524 U.S. at 170. *Phillips* speaks directly to our case when it states: "The government may not seize rents received by the owner of a building simply because it can prove that the costs incurred in collecting the rents exceed the amount collected." *Id.*

The majority also builds on *Phillips*'s other dissent, that of Justice Souter. From there, the majority derives the novel theory that a governmental appropriation of private property can be judged by the ad hoc analysis of *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978), rather than the categorical approach of *Loretto v. Teleprompter Manhattan CATV Corporation*, 458 U.S. 419 (1982) and *United States v. Causby*, 328 U.S. 256 (1946). Compare Maj. Op. at 15667-68 with *Phillips*, 524 U.S. at

176 (Souter, J., dissenting). But, contrary to the majority's assertion, it is not true that a court is free to choose whether it prefers the ad hoc approach or the per se approach in taking cases. Rather, the two approaches reflect different solutions to different problems.

Penn Central's ad hoc approach deals with regulatory takings--a difficult and vexing corner of takings law. This involves the situation where the government does not take property outright but, rather, limits the owner's use of the property for a regulatory purpose. Normally, the consequences of regulation are not compensable, because we must each bear the burdens--just as we enjoy the benefits--of living in a regulated society. For example, when the city requires a setback for buildings on residential lots, this is not a compensable taking because the regulation serves aesthetic and community purposes, and each property owner gets a correlative benefit from the fact that other homeowners can't build within the setback portion of their own lots. However, when a regulation goes "too far" in limiting the owner's use of the property, compensation is due. *See Dolan v. City of Tigard*, 512 U.S. 687 (1994); *Nollan v. Calif. Coastal Comm'n*, 483 U.S. 825 (1987). The way we determine whether a regulation goes "too far," and thus becomes a taking, is by applying the ad hoc weighing of *Penn Central*.

The ad hoc approach has never been applied to a case where the government actually takes and uses the property in question. Thus, to continue with the same example, it would be totally unthinkable--at least it was until today's opinion--that a court would apply an ad hoc analysis if the city were to seize 15 feet from every homeowner's setback for the purpose of widening the street. That would doubtless be treated as a compensable taking, even if the city could prove that the homeowners would derive great benefits from the widened street. Because the city has taken the 15

feet and used it for a public purpose, there is nothing to weigh and balance; the ad hoc approach is inapplicable.

The majority's blurring of the distinction between regulatory takings and physical takings is alarming. In a complex world, a property owner will always get *some* benefit, real or theoretical, from a taking of his property. Thus, even the family that gets booted from its home to make room for a freeway will get the benefit of a much faster commute from the park bench whence it must take up residence. Under an ad hoc approach, this would merely be an adjustment of the burdens of life in the big city. But the Supreme Court--in majority opinions--has held that the physical taking of *any* property by the government or its agents is a compensable taking, even if the property owner gets an offsetting--or even a net--benefit. *See Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). The majority in *Phillips*, in fact, relies on Loretto and not on *Penn Central*.

My colleagues try to avoid the clear teaching of *Phillips* by arguing that the per se approach of *Loretto* and similar cases applies primarily to takings of real property. Maj. Op. at 15667-68. Of course, this is not true; if the city wants to display your Renoir in its museum, it can't just take it and compensate you with the joy of viewing it during visiting hours. The majority seems to admit as much when it quickly adds "personal property" to the description of property covered by the per se approach. *Id. (quoting United States v. Sperry Corp.*, 493 U.S. 52, 62 n.9 (1989)). However, the majority finds it "particularly inappropriate" to apply a per se analysis when the property in question is money. But money is property and the majority gives no logical explanation for treating it differently. The majority argues that money is different because it is fungible. *See* Maj. Op. at 15667-69. But this makes no sense at all. If the government comes into your house and takes that Renoir

off your wall, you will suffer a compensable loss. You suffer the same loss if the government comes into your house and seizes an equal value in cash--the two events are indistinguishable for purposes of takings analysis. It is true that you might rue the taking of the Renoir more--you may have grown attached to it, or it may have sentimental value because you inherited it from Aunt Bertha who made you promise to keep it in the family. No matter, the government is entitled to take it, so long as it pays you the market value; you are entitled to nothing on account of your wounded feelings. *See United States v. Miller*, 317 U.S. 369, 375 (1943).

For purposes of the takings clause, then, real and personal property are reduced to their cash equivalents. It thus strikes me as peculiar and quite dangerous to say that the government has greater latitude when it takes money than when it takes other kinds of property. This portion of the majority's opinion will doubtless be greeted with a rousing cheer by government officials who will eagerly look to bank accounts and other places where money is kept, with an eye to snatching a few dollars here and there, and justifying it with some sort of "ad hoc" analysis.

The majority's reliance on a stray footnote in *Sperry*--discussing a very different proposition--does not survive scrutiny. As the Supreme Court explained in *Phillips*, *Sperry* dealt with a fee charged by the government for a service it rendered. The Court recognized that, where the government is entitled to be reimbursed for expenses it has incurred on the property owner's behalf, the charge is not a taking. In that context, the discussion of fungibility makes sense: If the government may charge a fee, it makes no difference whether it takes the money directly from the owner's funds or, instead, requires the owner to pay it separately. *Sperry*, 493 U.S. at 62 n. 9. Nowhere--and certainly not in *Sperry*--does the Supreme Court suggest that

the government's obligation to pay compensation is eliminated because it takes money rather than real or personal property. Indeed, *Phillips* makes it very clear that *Sperry* does not apply to this situation, because this is not a case where the government is charging for a service it renders. *See Phillips*, 524 U.S. at 171. My colleagues again disregard the teachings of the *Phillips* majority.

It is no doubt true that the IOLTA program serves a salutary purpose, one worthy of our support. As a citizen and former member of the bar, I applaud the state's effort to provide legal services for the poor and disadvantaged. But there is absolutely no reason appellants should have to give up their property to cover the full cost of this shared social responsibility. If the state believes that this is a service it should provide, it must be willing to pay for it. There ain't no such thing as a free lunch.

* * *

The case should be analyzed and decided precisely as in Judge Kleinfeld's opinion for the three-judge panel. Because I believe Judge Kleinfeld there sets out the proper analysis, and does so elegantly and persuasively, I adopt it in full as part of my dissent. For ease of reference, I reproduce Judge Kleinfeld's opinion as an appendix hereto.

[Judge Kleinfeld's opinion is reprinted in Appendix B.]

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 98-35154

D.C. No. CV-97-00146-JCC

WASHINGTON LEGAL FOUNDATION; ALLEN D. BROWN; DENNIS H. DAUGS; GREG HAYES; L. DIAN MAXWELL,
Plaintiffs-Appellants,

v.

LEGAL FOUNDATION OF WASHINGTON; KEVIN F. KELLY; BARBARA DURHAM, Chief Justice; GERRY L. ALEXANDER, Justice; JAMES M. DOLLIVER, Justice; RICHARD P. GUY, Justice; CHARLES WAYNE JOHNSON, Justice; BARBARA A. MADSEN, Justice; CHARLES Z. SMITH, Justice; PHILIP A. TALMADGE, Justice,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Washington
John C. Coughenour, District Judge Presiding

Argued and Submitted
February 9, 2000 -- Seattle, Washington

Filed January 10, 2001

Before: Stephen S. Trott, Andrew J. Kleinfeld, and Barry G. Silverman, Circuit Judges.

Opinion by Judge Kleinfeld.

KLEINFELD, Circuit Judge:

This case raises constitutional questions about Washington's program for applying interest on lawyers' (and others') trust accounts to various good works.

I. FACTS

Lawyers' ethical requirements have long required that "money of the client or collected for the client . . . should be reported and accounted for promptly, and should not under any circumstances be commingled with his own or be used by him."[1] The contemporary formulation is that a "lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person."[2]

In order to keep clients' money separated, a lawyer traditionally maintains a trust account separate from the law firm account, and keeps clients' money in the trust account. Clients advance money to lawyers for many reasons, such as for the closing of a business or real estate transaction, satisfaction of a claim, bail, and fees to be earned by the lawyer in the future but to be secured by the trust account deposit. Lawyers also receive money to be paid partly or entirely to their clients, perhaps after deduction of fees. Often insurance companies send settlement checks to plaintiffs' lawyers payable to the client "and" the lawyer. The lawyer has the

---

[1] *Cannons of Professional Ethics* Canon 11 (1908) (amended 1933).

[2] *Model Rules of Professional Conduct* Rule 1.15(a) (1999).

client endorse the check for deposit in the trust account by the lawyer and subsequent disbursement after the check clears, to third parties with claims, to the lawyer for his fees, and to the client. Traditionally, a law firm maintained one trust account in a non-interest bearing checking account for all its clients. Occasionally a separate interest bearing trust account or other device was used for a single client's money when the amount is large enough or the duration long enough to be worth maintaining a separate account.

Earlier in the century, lawyers often used to keep clients' money in separate envelopes in office safes.[3] After World War II (perhaps partly because banks had become safer), lawyers started placing funds in bank accounts separate from their law firm accounts.[4] Neither device generated any interest for the client or the lawyer, and the lawyer had to pay fees to the bank to maintain the trust account. Though the lawyer held the client's money as a fiduciary,[5] failure to obtain interest for the client was generally not a breach of fiduciary duty because none was obtainable as a practical matter. Interest was not paid on money in checking accounts, but except where the size and duration of the deposit were both large, no one concerned themselves about it. For a client to obtain interest on an amount held in trust, the expected interest had to exceed the value of the lawyer's time needed to establish a separate account, or else seeking interest made no economic sense. For the occasional circumstance where it was worth the

[3] *See Clark v. State Bar*, 246 P.2d 1, 4 (Cal. 1952).

[4] *See id.* Some lawyers became troubled about amounts in trust accounts exceeding FDIC insurance limits during the 80s when many banks failed.

[5] *Model Rules of Professional Conduct* Rule 1.15 cmt. 1 (1999).

time, lawyers would establish a separate interest bearing trust account so that the client could get the interest.[6]

Two things precipitated a change from the tradition that no interest was obtained from lawyers' trust accounts. First, in the 1970's, interest rates reached unprecedented high levels. Suppose $30,000 from a routine personal injury settlement were left in a non-interest bearing trust account for two weeks, while the insurer's check cleared and court reporters' and other expenses were paid. When rates were only 3%, only $35 in interest was lost, an amount less than the lawyers' fees and bank charges that would be required to maintain a separate account to obtain the interest. But when money market funds were paying 19%, a client stood to lose $219 on the same deposit. The interest was just too much to ignore.

Previously, banks were receiving the benefit of the use of the money in lawyers' non-interest bearing trust accounts, effectively as free loans from lawyers' clients, because before 1980, federal law prohibited federally insured banks and savings and loans from paying interest on checking accounts.[7] The competitive pressure on banks from money market funds and others led to the second change, a new federal statute allowing payment of interest on some demand accounts.

The combination of statutory and regulatory changes allowing payment of interest on some demand bank accounts

[6] *See In re Massachusetts Bar Ass'n*, 478 N.E.2d 715, 716 (Mass. 1985) (reviewing history of IOLTA movement.

[7] *See* 12 U.S.C. § 371a.

and high interest rates led to programs in all the states[8] where lawyers' trust accounts generated interest applied by nonprofit foundations under bar or court supervision to charities, such as provision of free legal services for poor people. This case involves Washington's IOLTA ("interest on lawyers' trust accounts") program.

The Washington Supreme Court created an IOLTA program in 1984 and codified it in the Washington Rules of Professional Conduct.[9] Lawyers are required, on pain of professional discipline, to hold small and short term moneys in interest bearing trust accounts, with the interest going to the Legal Foundation of Washington.[10] The Legal Foundation is a charitable organization established by the Supreme Court of Washington. Clients' funds in lawyers' trust accounts generate interest that the banks pay to the Legal Foundation of Washington. Clients' knowledge or

---

[8] *See Phillips v. Washington Legal Foundation*, 524 U.S. 156, 159 n.1 (1998). Since *Phillips* was decided, the last adopting state, Indiana, has instituted an IOLTA program. *See Indiana Professional Conduct* Rule 1.15(d) (2000).

[9] *Washington Rules of Professional Conduct* Rule 1.14 (2000).

[10] *See id.* The rules provide:

> A lawyer who receives client funds shall maintain a pooled interest-bearing trust account for deposit of client funds that are nominal in amount or expected to be held for a short period of time. The interest accruing on this account, net of reasonable check and deposit processing charges which shall only include items deposited charge, monthly maintenance fee, per item check charge, and per deposit charge, shall be paid to The Legal Foundation of Washington, as established by the Supreme Court of Washington. All other fees and transaction costs shall be paid by the lawyer. A lawyer may, but shall not be required to, notify the client of the intended use of such funds.

consent is not required. Clients are only entitled to the interest on their money, under the Washington IOLTA rules, if the interest earned would be greater than the bank fees and fees for lawyers' and accountants' time to establish a separate interest bearing account for the client or maintain sub-accounts in a pooled trust fund. The money held in trust for a length of time too short or in amounts too small to generate interest exceeding these fees and bank charges generates interest for the Washington Legal Foundation.[11] This case has the unusual twist (factually unusual, but it makes no difference analytically) that the IOLTA rules apply to some people who are not lawyers, and the non-lawyers are the plaintiffs. Some duties traditionally performed by lawyers are also performed in some localities by non-lawyers, frequently raising questions among the state bars and supreme courts about whether those services constitute the unauthorized practice of law. The issue of non-lawyers preparing documents for real estate transactions has been resolved by the Washington Supreme Court. In its rules for the bar, the Court has provided for "limited practice of law" by "closing officers," who are not lawyers but may nonetheless prepare these documents.[12] Closing officers, like lawyers, take money into trust, typically as escrow agents taking into trust the seller's signed documents and the buyer's money and exchanging them. The Washington Supreme Court bar rules require that where a limited practice closing officer prepares the papers, the money must be placed into the same IOLTA accounts as lawyers' trust funds.[13]

---

[11] *Washington Rules of Professional Conduct* 1.14(2) (2000).

[12] *Washington Admissions to Practice Rule* Rule 12 (2000).

[13] *Washington Admission to Practice Rules* Rule 12(b)-(c) (2000).

The title and escrow companies that employ closing officers do not have the same historical traditions as the bar. Traditionally, lawyers never received anything of value from the banks they used for trust accounts, and had to pay the bank fees for the trust accounts out of their law firm accounts, that is, the lawyers' own money. The escrow companies in Washington, like the lawyers, have in the past deposited money held in trust for customers in non-interest bearing trust accounts. Unlike the lawyers, the escrow companies have in the past received something of value in return from the banks. The banks did not pay them cash, but rather gave them credits applicable against bank fees. The credits were applied to such items as bank charges for money transfers, account reconciliations, and returned checks. Some escrow companies now charge their customers what they call "IOLTA fees" on the theory that IOLTA costs them money because they have lost these bank credits.

The small amounts of interest from each transaction in lawyers' and escrow companies' trust accounts add up to a lot of money, even though interest rates are not nearly as high as they were twenty years ago. In 1990 the program yielded $ 3.9 million for the Legal Foundation of Washington, in 1995, $ 2.7 million.

Appellants have varying concrete interests in the IOLTA program. Mr. Brown regularly buys and sells real estate in the course of his business, has engaged in at least one transaction where he knows interest on his $ 90,521.29 advance went to the Legal Foundation of Washington through the IOLTA program, and declares "I object to anyone other than me taking the interest earned on my funds." Mr. Hayes declares likewise, and also objects "to some of the activities engaged in" by the Legal Foundation and those to whom it distributes IOLTA money. Mr. Daugs owns an escrow company and is a limited practice officer.

According to his declaration, he has been violating the IOLTA rule so that his customers can have the benefit of earnings credits offsetting bank charges and because he objects to some activities of the Legal Foundation and its grantees. Ms. Maxwell is a former licensed limited practice officer employed by a title company that provides escrow services. Her company decided to fire all the limited practice officers to avoid the IOLTA rule and keep the bank credits, so she had to surrender her license and quit using some of her valuable skills in order to keep her job.

As an example of the activities some plaintiffs object to, they submitted a letter from the Legal Foundation to a legal services program saying "have I got a deal for you . . . . This means you can do work without regard to [Legal Services Corporation] restrictions for the first three quarters." The Legal Services Corporation, a federally funded national legal services program, provides funding for programs in the states, but legal restrictions prevent legal services staff attorneys from engaging in certain activities. The IOLTA money from Washington Legal Foundation is not encumbered by these restrictions. Thus the named plaintiffs object not only to losing the interest that IOLTA receives, and losing the free bank services they formerly received, but also to how the Legal Foundation uses the interest it obtains on their trust funds.

The named appellants and Washington Legal Foundation, a public interest advocacy group, sued the Legal Foundation of Washington and the Washington Supreme Court. They sought a declaratory judgment that the rules requiring limited practice officers to place clients' funds into IOLTA trust accounts, Washington Admission to Practice Rules 12(h) and 12.1, violated their First and Fifth Amendment rights. They also sought an injunction against disciplinary action for violating the rules and a refund of whatever interest IOLTA received from their deposits. On

cross motions for summary judgment, the defendants prevailed in district court.

II. ANALYSIS

Plaintiffs argue that the interest on their trust accounts belongs to the clients, and that the IOLTA program violates their Fifth Amendment right to the interest by taking it without just compensation. Plaintiffs further argue that the program violates their First Amendment right by forcing them to finance speech to which they object. We do not reach the First Amendment questions, because we conclude that plaintiffs are entitled to relief on their Fifth Amendment claim.

A. Ripeness.

Defendants argue that the Fifth Amendment claim is not ripe under *Williamson County Reg'l Planning Comm'n v. Hamilton Bank*.[14] In *Williamson*, a landowner sued in federal court for just compensation, claiming that county land use regulations were so onerous as to amount to a taking.[15] The Court held that the claim was not ripe for federal adjudication, because the landowner had not yet obtained a final decision from the county nor had it used the available state procedure for obtaining just compensation.[16] Under *Williamson*, ripeness of a claim for compensation for a taking requires that (1) "the government entity charged

[14] *Williamson County Reg'l Planning Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985).

[15] *See id.* at 175.

[16] *See id.* at 186.

with implementing the regulations has reached a final decision regarding the application of the regulations to the property at issue," and (2) the claimant has sought "compensation through the procedures the State has provided for doing so."[17] Defendants' theory is that plaintiffs have not met these requirements, and must sue for inverse condemnation in state court under Washington law before their Fifth Amendment claim can be ripe for federal adjudication. Defendants did not dispute ripeness in district court, but we consider it lest we overstep our jurisdiction.[18]

Unlike *Williamson*, there is no ongoing regulatory proceeding, so there is no occasion, as there was in *Williamson*, to await a final decision. There, the county zoning process was not yet complete. Here, what is at issue are general rules, Washington Rules of Professional Conduct Rule 1.14 and Washington Admission to Practice Rule 12, not an individualized regulatory proceeding. The process of promulgating the final rule has long since been concluded. Thus the "finality" requirement of *Williamson* does not preclude ripeness.

Most of what is at issue in this case is declaratory and injunctive relief, not the takings claim for $ 20 or so of lost interest. That $ 20 tail cannot wag the dog of this constitutional challenge to the IOLTA program into state court. *Williamson* generally keeps claims for just compensation in state court, but it does not exclude from federal

[17] *See id.* at 186, 194.

[18] *See Sinaloa Lake Owners Ass'n v. City of Simi Valley*, 882 F.2d 1398, 1404 (9th Cir. 1989). We need not decide whether takings clause ripeness doctrine is, as plaintiffs contend and as applied to this case, merely prudential and not jurisdictional, *see Suitum v. Tahoe Reg'l Planning Agency*, 520 U.S. 725, 733 (1997), because we reject defendants' ripeness argument.

court a claim for declaratory and injunctive relief to establish that a state law, on its face, violates the Fifth Amendment.[19]

Also, *Williamson* does not apply where "the inverse condemnation procedure is unavailable or inadequate."[20] Where resort to state remedies would be futile,[21] as when the state has no "adequate provision for obtaining compensation at the time of the taking,"[22] the second *Williamson* requirement does not apply. Futility is plain here. There cannot be a remedy under state law, because it is state law, and not merely an action by particular officials, that is being challenged. Were there any doubt about how the Supreme Court of Washington would respond were a challenge to be brought, the doubt is eliminated because the Court has already spoken in this case. The justices of that court are among the defendants, and they have filed a brief as appellees. The justices of the Supreme Court of Washington do not argue that the case is unripe, nor do they argue on any ground that they ought to have the opportunity to rule on this case before the federal courts do, nor do they suggest that any state remedy might be available. The justices argue that the IOLTA rule does not violate the Fifth Amendment. The IOLTA rule at issue, and the brief, filed in the justices'

---

[19] *See Suitum v. Tahoe Reg'l Planning Agency*, 520 U.S. 725 n.10 (1997); *Yee v. City of Escondido*, 503 U.S. 519, 533-34 (1992).

[20] *Williamson County Reg'l Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 197.

[21] *See City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687 (1999).

[22] *San Remo Hotel v. City and Council of San Francisco*, 145 F.3d 1095, 1101-02 (9th Cir. 1998).

capacity as such, leave no doubt that "the state has explicitly rejected its theory of the case."[23]

B. Property right.

Defendants argue that the clients whose money is deposited into an IOLTA account do not own a property right in the interest that money earns, so the Fifth Amendment protection of property does not pertain. The Fifth Amendment protects property rights but does not create them.[24] Under Washington law, they argue, the common law rule, "interest follows principal," does not necessarily apply, so the owner of principal in a trust account does not necessarily own the interest it generates. The Washington Supreme Court expressly considered and rejected objections to its IOLTA program on Fifth Amendment grounds, and stated in response to the objections that "interest on short-term or nominal client funds . . . does not constitute 'property' as defined by the United States or Washington Constitutions."[25]

One of the amicus briefs argues that "clients lose nothing because of IOLTA," because were it not for the pooling, the clients could get no interest, because the costs of administering the accounts to produce it would exceed the amounts produced. Indeed, the IOLTA rule is written so that if the interest would exceed the administrative costs of obtaining and crediting it, then the money should not be deposited into the IOLTA trust account.

---

[23] *Levald, Inc. v. City of Palm Desert*, 998 F.2d 680, 689 (9th Cir. 1993).

[24] *See Board of Regents v. Roth*, 408 U.S. 564, 577 (1972).

[25] *IOLTA Adoption Order*, 102 Wn. 2d 1101, 1109 (1984).

This is more a practical than a legal argument insofar as it addresses who owns the interest. The claim is not that the trust accounts do not produce interest, but only that the administrative expense of sharing it among the clients would exceed the amount earned. The money deposited into the trust account is the clients' money. If the clients own the interest, it might be worth it to them to pay the expense and collect it even if the lawyers or escrow companies did not think it worth the bother. One of the affidavits in this case establishes that a client might well say (and the affiant more or less does), "it is not so much that I want the $ 20, though I do, as that I don't want the Legal Foundation's donees to get it, because I don't like what they do with it." If lawyers and escrow companies had to pay trust account interest to clients, then software programs might be developed to make it easy to do it. If pooling works to generate interest for IOLTA, then it could presumably be made to work to generate interest for clients. Also, as the affidavits in this case demonstrate, the clients can and do suffer a detriment if the interest is given to the Legal Foundation, because the escrow companies impose charges on the clients to compensate themselves for the bank credits they formerly obtained. The property question is whether the clients own the interest, not whether the amounts are so small it is not worth the clients' while to collect it.

The circuits had been split on this question,[26] and were when the district court ruled. Subsequent to that ruling, the Supreme Court definitively answered the question, in

[26] *Compare Cone v. State Bar of Florida*, 819 F.2d 1002 (11th Cir. 1987) *with Washington Legal Found. v. Texas Equal Access to Justice Found.*, 94 F.3d 996 (5th Cir. 1996).

Phillips v. Washington Legal Foundation:[27] the clients own the interest.

Phillips was a Fifth Amendment challenge to the Texas IOLTA program. It is materially similar to the Washington IOLTA program at issue here. Similar language was used in Texas to limit the pooled IOLTA trust funds to short term and nominal amounts that would not generate interest for clients exceeding the administrative costs of paying it to the clients. The question the Court considered was "whether interest earned on client funds held in IOLTA accounts is 'private property' of either the client or the attorney for purposes of the Takings Clause of the Fifth Amendment."[28] The Court answered by saying, "[we] hold that it is the property of the client."[29]

Defendants argue that *Phillips* should be distinguished because it depends on Texas law, and Washington law differs. The distinction is unpersuasive, for several reasons. Basically, *Phillips* is not based on some odd quirk of Texas law, but on a fundamental and pervasive common law principle accepted by both states. The central question in this case was open and subject to serious arguments on both sides before *Phillips*, but not after.

Phillips begins with the proposition that the principal in the trust accounts belongs to the client. Though one [of] the defendants' briefs argues otherwise, on the ground that a bank is merely a debtor of the depositor whose duties depend on contract, that proposition is irrelevant. The relationship at issue is not between the bank and the lawyer or

[27] *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998).

[28] *Id.* at 160.

[29] *Id.*

escrow company, but between either of them and the client. The Washington IOLTA rules, like the Texas rules, refer to the money at issue as "client funds," and "funds of clients" and "his or her funds," as distinguished from "funds belonging to the lawyer."[30] The only reason that the moneys at issue go into trust accounts instead of the firm accounts of the lawyers and escrow companies is that the money belongs to the clients, not the lawyers or escrow companies.[31]

Next, *Phillips* takes note of the well established rule that "interest follows principal" "as the shadow the body."[32]

> The rule that "interest follows principal" has been established under English common law since at least the mid-1700's. *Beckford v. Tobin*, 1 Ves.Sen. 308, 310, 27 Eng.Rep. 1049, 1051 (Ch. 1749) ("Interest shall follow the principal, as the shadow the body"). Not surprisingly, this rule has become firmly embedded in the common law of the various States.[33]

Phillips also responds to the practical argument discussed above, that the IOLTA program takes interest only from clients who would receive none, because the amounts are too small or deposited for too short a time to generate interest in excess of administrative expense to distribute it. The Court held that the interest is property protected under the Fifth Amendment even if "it lacks a positive economic

---

[30] *Washington Rules of Professional Conduct* Rule 1.14 (2000).

[31] *Model Rules of Professional Conduct* Rule 1.15 (1999).

[32] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 165 (1998).

[33] *Id.*

or market value."[34] "While the interest income . . . may have no economically realizable value to its owner, possession, control, and disposition are nonetheless valuable rights that inhere in the property."[35] This holding vindicates the plaintiffs' claim in the case at bar that they do not want interest on their money going to the application to which the Legal Foundation of Washington has elected to contribute it.

Phillips goes on to establish a striking proposition: states are not free to take away the client's property right to the interest by statutes depriving them of property rights in it.[36] This holding in *Phillips* speaks conclusively to defendants' argument that the clients in Washington do not own the interest because the Washington IOLTA rule so established as a matter of state law, and the Washington Supreme Court so stated in the dialogue about whether to adopt the IOLTA rule. The Supreme Court in *Phillips* noted that in a previous decision, *Webb's Fabulous Pharmacies, Inc. v. Beckwith,*[37] it held that a Florida statute governing interpleaders violated the takings clause. The statute at issue in *Webb's* provided that where a party deposits a sum with the clerk of the court the interest on that principal "shall be deemed income of" the clerk's office or the court. Were a state able, by court rule or statute, to establish ownership of interest in one other than the owner of the principal, this statute would have vitiated the Fifth Amendment. But

---

[34] *Id.* at 169.

[35] *Id.* at 170.

[36] *See id.* at 171.

[37] *See Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980).

Webb's held that the statute, analogous to Washington's IOLTA rule, violated the Takings Clause.[38]

> "'[A] state by ipse dixit, may not transform private property into public property without compensation' simply by legislatively abrogating the traditional rule that 'earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property.' In other words, at least as to confiscatory regulations as opposed to those regulating the use of property, a State may not sidestep the Takings Clause by disavowing traditional property interests long recognized under state law."[39]

We applied *Phillips* in, *Schneider v. California Department of Corrections*.[40] There, prison inmates in California maintained small amounts of money in trust accounts, to purchase such personal convenience items as toothpaste at the prison canteens. A California statute provided that interest earned on inmates' money in the trust account would go to a state "inmate welfare fund" rather than to the individual inmate. Even though the state statute purported to eliminate any property interest the inmates might own to interest on their money, we held that under *Phillips*, "constitutionally

---

[38] *See id.* at 164-65.

[39] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 167 (1998).

[40] *Schneider v. California Dep't of Corrections*, 151 F.3d 1194 (9th Cir. 1998).

protected property rights can--and often do--exist *despite* statutes . . . that appear to deny their existence."[41]

We noted in *Schneider* that in *Phillips* and *Webb's*, the Supreme Court had held that "a State may not sidestep the Takings Clause by disavowing traditional property interests long recognized under state law,"[42] and both cases relied on the common law rule that "interest follows principal" "in the face of a contrary state statute."[43] To explain how this could be, we explained in *Schneider* that "*Roth* stands not for a theory of plenary state control over the definition and recognition of compensable property interests,"[44] but rather that "there is, we think, a 'core' notion of constitutionally protected property," and a state's power to alter it by legislation "operates as a one-way ratchet of sorts," allowing the states to create new property rights but not to encroach on traditional property rights.[45] We recognized in *Schneider*, as the Supreme Court did in *Webb's* and *Phillips*, that "were the rule otherwise, States could unilaterally dictate the content of--indeed altogether opt out of--both the Takings Clause and the Due Process Clause simply by statutorily re

---

[41] *Id.* at 1194.

[42] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 167 (1998).

[43] *See id.; Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 162 (1980).

[44] *Schneider v. California Dep't of Corrections*, 151 F.3d 1194, 1200 (9th Cir. 1998).

[45] *Id.*

characterizing traditional property-law concepts."[46] Thus, for example, a state could obtain vast moneys for good works until everyone with large sums of money moved it out of state, by passing a law stating that all amounts in excess of $100,000 on deposit in any financial institutions are the property of the state. *Schneider* holds that the "common law pedigree" since 1749 of the rule that interest follows principal, and its "near-universal endorsement by American courts," establishes that "interest income of the sort at issue here is sufficiently fundamental that States may not appropriate it without implicating the Takings Clause."[47]

Phillips' and *Schneider*'s rejection of positive state law as a means of avoiding the Takings Clause, disposes of the proposition that there is no taking because Washington, in its IOLTA program, has established as a matter of positive law that interest does not follow principal with respect to small and short term deposits in client's trust accounts. Texas, after all, had also established its IOLTA program as law, so if property rights in interest could be destroyed by state law in that manner, *Phillips* had to come out the other way. A state cannot avoid the Fifth Amendment limitation on takings of property by legislating away the property right.

All that is left as a possible distinction of this case from *Phillips* is that Washington, unlike most common law jurisdictions, has not accepted the common law rule that interest follows principal. Exceptions to the rule will not establish a contrary view, because there were exceptions in Texas. Despite those exceptions, *Phillips* held that the client's ownership of the principal in the trust account still gave the client a property right in the interest. Defendants have to

---

[46] *Schneider v. California Dep't of Corrections*, 151 F.3d 1194, 1201 (9th Cir. 1998).

[47] *Id.*

establish that Washington is an anomaly among common law jurisdictions, not merely by having some exceptions, but by not having accepted the virtually universal rule.

Not surprisingly, the case for Washington's anomalous status cannot be made. Most American jurisdictions adopted the common law in what are called "reception" statutes. Washington has a quite ordinary reception statute: "The common law, so far as it is not inconsistent with the Constitution and laws of the United States, or of the state of Washington nor incompatible with the institutions and condition of society in this state, shall be the rule of decision in all the courts of this state."[48] This ordinary reception of the common law was codified by the Territory of Washington in 1862, well before statehood, so no property owner in Washington has had to fear that by entering the state he or she was leaving behind the protection of the common law, including the rule that interest follows principal. In 1895, the Washington Supreme Court in *Tacoma School District v. Hedges*[49] applied the rule in holding that interest on delinquent taxes should go to the school districts entitled to the principal amount of the taxes, not to the general funds of the counties collecting the taxes. A century later, the court applied the rule similarly in *City of Seattle v. King County*[50] based on the "common law principle that interest on public funds follows ownership of those funds."[51] Defendants note some Washington statutory exceptions to the common law

---

[48] Wash. Rev. Code § 4.04.010 (2000).

[49] *Tacoma School District v. Hedges*, 42 P. 522 (Wash. 1895).

[50] *City of Seattle v. King County*, 762 P.2d 1152, 1153 (Wash. Ct. App. 1988).

[51] *Id.* at 1155.

rule,[52] but they are of no more significance than the Texas exceptions that the Court in *Phillips* deemed insufficient to overcome the Fifth Amendment significance of the common law rule. Statutes in derogation of the common law in a few limited and specialized circumstances do not work a general abrogation of the common law outside their scope.[53]

C. Taking.

Phillips did not express a view on whether the Texas IOLTA law was a taking, nor on the amount of compensation due if it was,[54] because the circuit from which certiorari had been taken only addressed whether the interest was the client's property, and the petition for certiorari

---

[52] *See* Wash. Rev. Code § 18.85.310(5) (real estate brokers must deposit nominal deposits in trust accounts, the interest to be used for low income housing and continuing education for real estate professionals); Wash. Rev. Code § 36.48.090 (interest on bail goes to county expenses, not those posting the bail); Wash. Rev. Code § 59.18.270 (landlords receive the interest on tenants' security deposits). These three statutes were adopted, respectively, in 1995, 1963, and 1973, long after the reception of the common law rule that interest follows principal. We have no occasion, of course, to consider the constitutionality of these provisions.

[53] Sutherland Stat. Const. § 61.01-61.06 (5th Ed.). The old maxim that statutes in derogation of the common law are strictly construed may be incorrect as prescription or description of how such statutes are actually construed. But as a description of how legislatures promulgate laws, it is correct to say that by legislating on one matter, they do not abrogate all common law inconsistent with the new statute on other matters that were not even before them at the time.

[54] *See Phillips v. Washington Legal Foundation*, 524 U.S. 156, 172 (1998).

addressed only that question.[55] Defendants argue that even if interest on client trust funds is the property of the clients, the IOLTA rule works no taking. The district court did not reach the question of whether there was a taking for which compensation was due because *Phillips* had not yet been decided by the Supreme Court when it ruled. The district judge relied on the one circuit court case then on the books,[56] which has since been superseded by *Phillips*.

Plaintiffs presented evidence that for at least one of them, a measurable amount of money, about $ 20 in interest, was diverted to the Legal Foundation. *Phillips* holds that even where the client's interest on trust accounts "may have no economically realizable value to its owner, possession, control and disposition are nonetheless valuable rights that inhere in the property."[57] To apply that concretely, a real estate purchaser might want interest on his money to go to his or her preferred charity, perhaps a church, a school, Mothers Against Drunk Driving, or the local Rescue Mission, rather than the Legal Foundation's preferred charity, legal services for indigents, even if that interest could not be realized by the real estate purchaser. Plaintiffs submitted evidence that at least some of them do in fact object to their interest going to the Legal Foundation's grantees.

Defendants argue that there has been no taking because there has been no physical invasion of tangible property. They rely on the Supreme Court's statement in *Penn Central*

---

[55] *See id.* at n.4.

[56] *See Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962 (1st Cir. 1993).

[57] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 170 (1998).

Transportation Co. v. New York City[58] that "[a] taking may more readily be found when the interference with property can be characterized as a physical invasion by the government."[59] But their argument uses the statement out of its context, which was regulation of real estate to preserve a historically and architecturally important building. The statement cannot be applied in the distinguishable context of money deposited in banks or invested in securities or money market funds. This would imply the nonsensical proposition that a taking would less readily be found if a state entirely confiscated people's money from their bank accounts or IRA's than if it installed a sign on their land.

Defendants seem to be arguing that the government can confiscate people's money without it being a taking compensable under the Fifth Amendment, based on cases where the government provided a service and charged a reasonable user fee for the service.[60] Taken out of the context of users' fees, the proposition is absurd. Unlike medieval England, most assets are now held in the form of fungible intangibles such as bank accounts, money market accounts, and securities. The Fifth Amendment protection of property would be eviscerated were we to construe confiscation of fungible intangibles as not amounting to a taking, as defendants urge. The Supreme Court drew precisely this distinction, between reasonable users' fees and the interest on IOLTA accounts, in *Phillips*, noting that it "would be a different case" if the state were "imposing reasonable fees it incurs in generating

---

[58] *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978).

[59] *Id.* at 124.

[60] *See e.g., United States v. Sperry Corp.*, 493 U.S. 52 (1989).

and allocating interest income."[61] *Phillips* holds that *United States v. Sperry Corp.*,[62] the user fee case, has no application to complete "confiscation of respondents' interest income" by an IOLTA program where the funds are managed by banks and private individuals.[63]

Defendants make another, more appealing, argument from *Penn Central* that the "economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations."[64] The argument is that, because the plaintiffs could not have realized any money from the IOLTA funds, the economic impact is nonexistent, and because the IOLTA rule was in effect when they acted, the IOLTA rule could not have interfered with their expectations.

This argument fails on several independent grounds. First, the "economic impact" test is articulated in *Penn Central* in the context of regulation of the use of real estate, not deprivation in its entirety of any property. The point of the economic impact test in *Penn Central* is to distinguish government regulations of the owner's use of property permissible under its police power from those that go too far, requiring the government to compensate the owner for

---

[61] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 171 (1998).

[62] *See also* our user's fee decision in *Commercial Builders of Northern California v. City of Sacramento*, 941 F.2d 872 (9th Cir. 1991).

[63] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 171 (1998).

[64] *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 124 (1978).

taking his property. That distinction is not necessary or appropriate where the government entirely appropriates a sum of money belonging to a private individual. The economic impact test would have relevance if the IOLTA rule merely regulated how the client used his interest, or where the interest was kept, or for how long. But that is not the case. The IOLTA rule entirely appropriates the interest on the client's principal in a trust account, so the distinction between regulation under the police power and a taking subject to Fifth Amendment protection is not affected by the economic impact.

This analysis is compelled by *Loretto v. Teleprompter Manhattan CATV Corp.*[65] There, a city required landlords to allow cable television companies to put cables on their roofs. The Court held that this permanent physical occupation of a portion of roof space was a "taking" "without regard to the public interests that it may serve,"[66] and without regard to the "minimal economic impact on the owner."[67] The Court held that the multi-factor test in Penn Central does not apply [*40] to a permanent physical occupation, as was the case for those parts of the roof on which the cables were mounted.[68] *Phillips* applied *Loretto*, in the context of IOLTA interest rather than physical inva-

[65] *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982).

[66] *Id.* at 426.

[67] *Id.* at 435.

[68] *See id.* at 432.

sion of real property.[69] And *Phillips* interpreted *Loretto* to mean that property was "taken" "even when infringement of that right arguably *increased* the market value of the property at issue."[70] Thus, says *Phillips*, drawing an analogy to IOLTA interest, "the government may not seize rents received by the owner of a building simply because it can prove that the costs incurred in collecting the rents exceed the amount collected."[71] The Court in *Phillips* also expressly rejected the argument that because federal tax and banking regulations are what enables IOLTA to generate interest, there is no property right, on the ground that "the State does nothing to create value; the value is created by respondent's funds."[72] When the government permanently appropriates all of the interest on IOLTA trust funds, that is a *per se* taking, as when it permanently appropriates by physical invasion of real property.[73]

Second, it is not quite correct to say that IOLTA as structured does not deprive clients of any money. The rule says that in determining whether to deposit money held in trust into the IOLTA account or an account where the client will receive the interest, a lawyer must consider "only whether the funds to be invested could be utilized to provide a positive net return to the client," based on the interest to be earned while the funds "are expected to be" deposited,

[69] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 169-70 (1998) (emphasis in original).

[70] *Id.* at 170.

[71] *Id.* at 170.

[72] *Id.* at 171.

[73] *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992).

and the various expenses including lawyers' fees for administering interest payable to the client.[74] This leaves two ways in which, as a practical matter, the client may lose an economically significant amount of interest. One, probably quite common, is where the funds "are expected to be" deposited for a much shorter period than they actually are. For example, disbursement to a client may be delayed because a physician who treated him in exchange for a pro tanto assignment of settlement proceeds calls to say that another bill is coming. A closing on a house may be delayed because the engineer whose report the bank needs catches the flu and finishes the report a couple of weeks late. All sorts of reasons intervene so that expected one day deposits, originally thought to produce interest less than the anticipated expense of paying it to the client, turn into deposits for a few weeks.

The second way a client may lose interest is that the costs of lawyers' and closing officers' services are overestimated. As a practical matter, the lawyers and closing officers have a substantial incentive not to be bothered with crediting clients with their interest. It is therefore in their interest to say of almost all routine trust deposits that no significant interest will accrue and to place the money into the IOLTA account. But a client, whether out of desire that he or she get every penny coming to them, a feeling of getting "nickeled and dimed," or an objection to contributing money to lawyers' and judges' favorite charity, may think it is worth having a lawyer spend $ 19.95 worth of time to get the client $ 20 in interest. Also, the amount of time and trouble involved in collecting, allocating, and distributing

---

[74] *Washington Rules of Professional Conduct* Rule 1.14(3). The rule for closing officers, *Washington Admission to Practice Rules* Rule 12.1(b)(3), is analogous, except that "cost of closing officer's services" is substituted for "cost of lawyer's services."

interest to clients depends on how often it is done. If done once, it is probably a costly nuisance. If done frequently, it may become delegable to nonprofessional staff using off the shelf software.

D. Remedies.

Defendants argue that even if the interest is the client's property, and even if the IOLTA rule effects a taking, the Fifth Amendment nevertheless affords no remedy because the "just compensation" is zero. On this point, which the district court did not reach, a remand is necessary. The Fifth Amendment does not prohibit the taking of private property for public use; it allows it.[75] What it prohibits is the taking of private property for public use "without just compensation."[76]

Defendants argue that no equitable relief is available to enjoin a taking of private property for public use, citing *Ruckelshaus v Monsanto*.[77] *Monsanto* does not preclude all equitable relief related to a taking, but it does prevent a court in most circumstances from enjoining the taking itself. Even though the Washington IOLTA rule is a taking of private property for public use from clients of lawyers and closing officers, that does not necessarily entitle or require a district court to enjoin operation of the rule. The clients are entitled to just compensation, not to prevention of the taking, just as they would be if the state were taking their real estate to build a highway. Plaintiffs' prayer for relief seeks "reimbursement" of the interest taken from them.

---

[75] *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987); *Macri v. King County*, 126 F.3d 1125 (9th Cir. 1997).

[76] U.S. Const. amend. V.

[77] *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984).

"Reimbursement" is not a correct form of relief, because plaintiffs never had possession of the interest that was taken from them, and, as explained below, reimbursement may be an incorrect measure of "just compensation."

Monsanto does not address all the equitable relief demanded, only the taking itself. Though they cannot enjoin the government from taking their interest for public use, plaintiffs are entitled to a declaratory judgment that taking their interest for public use without paying them just compensation, under the IOLTA rule, violates the Fifth Amendment. Plaintiffs also seek an injunction prohibiting the Washington Supreme Court from taking disciplinary action against limited practice officers (the closing officers escrow companies employ) for refusing to deposit clients' money into the IOLTA account, or from conditioning their licenses on complying with IOLTA rules. We do not decide whether such an injunction would be appropriate, because the district court has not yet considered the issue, but if it would otherwise be appropriate, *Monsanto* would not bar an injunction. *Monsanto* prevents courts from enjoining takings. This equitable relief would not enjoin takings, but would instead be addressed to saving the jobs of title and escrow company employees caught between the IOLTA rules and employers who do not want to employ anyone who will comply with the IOLTA rules.

Defendants correctly argue that the measure of just compensation is not the value that the government gains, but rather the value that the person whose property was taken loses.[78] Ordinarily if money is taken, it comes to the same thing, but not necessarily in this case. The evidence before

---

[78] *See Williamson County Reg'l Planning Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985); *United States v. 564.54 Acres of Land*, 441 U.S. 506 (1979); *Boston Chamber of Commerce v. City of Boston*, 217 U.S. 189 (1910).

us allows for differing conclusions, so there is a genuine issue of fact on this record. It is possible that the interest gained by the defendants exceeds the amount of the loss by the clients.

Plaintiffs' submissions include what the escrow companies call "IOLTA fees" charged to customers whose money is put into the IOLTA account. These fees and the affidavits explaining them support an inference that the clients are harmed financially by the IOLTA program, but the "IOLTA fees" do not measure the loss. The IOLTA fees are not charged by IOLTA, but by the title and escrow companies. Before IOLTA the banks previously received the benefit of the "float," that is, the interest-free loans lawyers gave them of their clients' money, and escrow companies of their customers' money, when it was held in trust accounts. A bank account is a loan of money by the depositor to the bank.[79] Before IOLTA, the banks "kicked back" part of this benefit of this interest-free loan to the title and escrow companies. The customers who put the funds in escrow, and had equitable title to them, received nothing. Now that IOLTA receives the benefit of the "float" instead of the banks, the banks no longer share it with the title and escrow companies, in the form of credits against bank charges. So the title and escrow companies charge customers an amount they refer to as "IOLTA fees," not based on any fees charged by IOLTA, but rather on their loss of benefits they previously shared with the banks from interest-free deposits of their customers' money. Because the interest is property taken from the customers, not the title and escrow companies, just compensation is due to the customers, not the title and escrow companies, and is measured by the loss to the customers, not the title and

---

[79] *See IT Corp. v. General Am. Life Ins. Co.*, 107 F.3d 1415, 1422 (9th Cir. 1997).

escrow companies. The significance of the mislabeled "IOLTA fees" and loss of bank credits is that it shows some compensable value was there, even though the value was being retained by the title and escrow companies rather than the customers whose money they took in trust.

The Court in *Phillips* drew a distinction that implies the proper resolution of the just compensation measure (and with it, the constitutionally permissible form of an IOLTA program). Phillips says that the taking of interest on trust accounts "would be a different case" if the state were "imposing reasonable fees it incurs in generating and allocating interest income."[80] *Phillips* cites *Sperry*[81] in reference to this "different case" IOLTA plan. In *Sperry*, the government caused a fund to be generated for victims of Iranian revolutionary confiscations and charged a fee of 2% for expenses incurred in connection with the arbitration of claims and the maintenance of the fund.[82] By analogy with the Iranian confiscation fund, it may be the case that but for the efforts of the Washington Bar and Supreme Court, the banks and escrow companies would still get the benefit of the clients' and customers' money deposited into their trust accounts. For their service in "generating and allocating interest income," the Legal Foundation may be justified in "imposing reasonable fees" analogous to the fees the government charged on the Iranian confiscation fund. There have to be some expenses, for the clerical and administrative efforts in managing the flow and accounting for IOLTA funds. The IOLTA program managers have to pool the clients' moneys deposited into trust and make the arrangements with the banks, or there is no interest.

[80] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 171 (1998).

[81] *United States v. Sperry Corp.*, 493 U.S. 52 387 (1989).

[82] *See id.* at 57.

Just as a client is not entitled to the full amount that a lawyer collects for him, but only that amount less the lawyer's reasonable expenses and fees,[83] so just compensation for interest taken by IOLTA after IOLTA causes the interest fund to exist is something less than the amount of the interest. This analogy to the restitution theory applicable to lawyers' fees for producing a common fund is only partial. The principal, not the lawyers' efforts, produces the interest.[84] But there is some analogy to common fund cases, and to the Iranian confiscations fund in *Sperry*, because there would be no interest that could flow to the individual clients but for substantial administrative and clerical efforts to administer the IOLTA program, both to assure that lawyers' and escrow companies' trust funds went into the pooled accounts, and to distribute interest to clients out of pooled accounts.[85]

Even though when funds are deposited into IOLTA accounts, the lawyers expect them to earn less than it would cost to distribute the interest, that expectation can turn out to be incorrect, as discussed above. Several hypothetical cases illustrate the complexities of the remedies, which need further factual development on remand. Suppose $2,000 is deposited into a lawyer's trust account paying 5% and stays

[83] *See Paul, Johnson, Alston & Hunt v. Graulty*, 886 F.2d 268, 271 (9th Cir. 1989).

[84] *See Phillips v. Washington Legal Foundation*, 524 U.S. 156, 168 (1998).

[85] An additional detail not clear from the record as it stands is whether the interest could flow to clients, or only to charities selected by clients, under the restrictions applicable to financial institutions in which trust funds could prudently be pooled.

there for two days. It earns about $.55, probably well under the cost of a stamp and envelope, along with clerical expenses, needed to send the $.55 to the client. In that case, the client's financial loss from the taking, if a reasonable charge is made for the administrative expense, is nothing. The fair market value of a right to receive $.55 by spending perhaps $ 5.00 to receive it would be nothing. On the other hand, suppose, hypothetically, that the amount deposited into the trust account is $ 30,000, and it stays there for 6 days. The client's loss here would be about $ 29.59 if he does not get the interest, which may well exceed the reasonable administrative expense of paying it to him out of a common fund. It is hard to see how just compensation could be zero in this hypothetical taking, even though it would be in the $2,000 for 2 days hypothetical taking. It may be that the difference between what a pooled fund earns, and what the individual clients and escrow companies lose, adds up to enough to sustain a valuable IOLTA program while not depriving any of the clients and customers of just compensation for the takings. This is a practical question entirely undeveloped on this record. We leave it for the parties to consider during the remedial phase of this litigation.

E. First Amendment Claim

Plaintiffs claim that the IOLTA program violates the First Amendment because it forces clients of lawyers and customers of escrow companies to contribute their interest money to groups such as legal services programs asserting public positions with which they disagree. Because plaintiffs prevail on their Fifth Amendment claim, and because the district court did not reach the First Amendment claim, we do not reach the First Amendment claim.

III CONCLUSION

IOLTA programs spread rapidly because they were an exceedingly intelligent idea. Money that lawyers deposited in bank trust accounts always produced earnings, but before IOLTA, the clients who owned the money did not receive any of the earnings that their money produced. IOLTA extracted the earnings from the banks and gave it to charities, largely to fund legal services for the poor. That is a very worthy purpose. But as *Phillips* reminds us, the interest belongs to the clients. It does not belong to the banks, or the lawyers, or the escrow companies, or the state of Washington. If the clients' money is to be taken by the State of Washington for the worthy public purpose of funding legal services for indigents or anything else, then the state of Washington has to pay just compensation for the taking. That serves the purpose of imposing the costs on society as a whole for worthwhile social programs, rather than on the individuals who have the misfortune to be standing where the cost first falls.[86]

In sum, we hold that the interest generated by IOLTA pooled trust accounts is property of the clients and customers whose money is deposited into trust, and that a government appropriation of that interest for public purposes is a taking entitling them to just compensation under the Fifth Amendment. But just compensation for the takings may be less than the amount of the interest taken, or nothing, depending on the circumstances, so determining the remedy requires a remand.

REVERSED and REMANDED.

---

[86] *See Armstrong v. United States*, 364 U.S. 40, 49 (1960).

APPENDIX C

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

WASHINGTON LEGAL, FOUNDATION, ALLEN D. BROWN, DENNIS H. DAUGS, GREG HAYES, and L. DIAN MAXWELL,	)	No. C97-0146C
	)	ORDER
Plaintiffs, v.	)	
LEGAL FOUNDATION OF WASHINGTON, KEVIN KELLY, BARBARA DURHAM, GERRY L. ALEXANDER, JAMES M. DOLLIVER, RICHARD P. GUY, CHARLES W. JOHNSON, BARBARA A. MADSEN, CHARLES Z. SMITH, and PHILIP A. TALMADGE,	)	
Defendants.	)	

This case questions whether Washington's promulgation of rules regulating Interest on Lawyer Trust Accounts (IOLTA) for Limited Practice Officers (LPOs) violates the U.S. Constitution. Plaintiffs are the Washington Legal Foundation (WLF), Allen D. Brown, Dennis H. Daugs, Greg Hayes, and L. Dian Maxwell (collectively referred to as Plaintiffs). Defendants are the Legal Foundation of

Washington (LFW), and nine Washington Supreme Court Justices (Justices) (collectively referred to as Defendants). The matter is presently before the Court on Plaintiffs' Motion for Summary Judgment, Supreme Court of Washington's Motion for Summary Judgment, and LFW Defendants' Motion for Summary Judgment, all of which are, in effect, cross-motions for summary judgment. There are no material issues fact. The Court has heard oral argument.

I. History

In 1980 federal banking regulations changed to allow negotiable order of withdrawal (NOW) accounts, that are, in effect, interest bearing checking accounts. These accounts allow attorneys to pool client funds, separate from the attorney funds, into an interest bearing account. NOW accounts may not contain funds from for-profit corporations.

These client pooled funds led to the creation of IOLTA programs in all fifty states. These programs are premised on the idea that the interest created by the pooled funds could not create a net profit (the cost of maintaining the account and dispersing individual earnings exceed the interest that the client-depositor would receive) for the client-depositor. This may be because of the period of time in which the funds are to be held, the amount of money to be held, or some combination thereof.

Washington adopted an IOLTA program for lawyers in 1985. IOLTA Adoption Order, 102 Wn.2d 1101 (1984). In the adoption order, the Washington Supreme Court considered arguments by opponents of the program, and concluded, inter alia, that the client-depositors did not have a property interest in the net profit of the IOLTA accounts, nor did the program violate the Fifth Amendment of the U.S. Constitution.

Since their creation, the WLF has challenged IOLTA programs in several state and federal courts. The most recent of these challenges, Washington Legal Fund v. Texas Equal Access to Justice Foundation (hereinafter TEAJF), 94 F.3d 996 (5th Cir. 1996), cert. granted sub nom, Phillips v. Washington Legal Foundation, 66 U.S.L.W. 3030 (July 15, 1997), was argued before the Supreme Court on January 13, 1998. The specific issue before the Court in that case is whether the client-depositors or lawyers have a property interest in the proceeds of the IOLTA accounts. The Fifth Circuit, concluded that there was a property interest.

LPOs are "lay persons [who are authorized] to select, prepare, and complete legal documents incident to the closing of real estate and personal property transactions" in proscribed situations. APR 12(a). LPOs are authorized and regulated by the Washington Supreme Court. On September 21, 1995, the Washington Supreme Court initiated a mandatory IOLTA program for the transactions handled by an LPO.

II. Stay of Proceedings

As a preliminary matter, the Justices move to stay the determination of this motion until the Supreme Court decides Philips. The Court denied a motion to stay these proceedings in its October 16, 1997, Minute Order. The Justices present no argument that would justify reconsideration of that decision.

III. Collateral Estoppel

First, the Justices argue that Plaintiffs' First and Fifth Amendment claims are barred by collateral estoppel. The Justices contend that the WLF litigated and lost claims identical to these in Massachusetts Legal Found. v. Massachu-

setts Bar Found., 993 F.2d 962 (1st Cir. 1993). Neither side contends that the Washington LPO IOLTA program could have been challenged, nor that the Justices could have been joined as defendants in Massachusetts Bar Found.

The Justices assert a form of defensive, nonmutual collateral estoppel. See Blonder-Tongue Laboratories v. University of Il. Found., 91 S. Ct. 1434 (1971). The Justices argue that Montana v. United States, 99 S. Ct. 970 (1979), provides a two prong test to determine the applicability of collateral estoppel. Namely, that they need only demonstrate that the claims are "identical" and that WLF litigated and lost in the previous action. In Montana v. United States, the United States directed individuals to litigate the constitutionality of a Montana receipt tax; there was no dispute that the United States financed and controlled the litigation. Id. at 972. On review, the Montana Supreme Court upheld the tax. Id. The individuals did not appeal to the United States Supreme Court. Id. The United States brought a second action in federal court, which challenged the constitutionality of the same Montana tax. Id. On review, the United States Supreme Court held that the United States was collaterally estopped from relitigating the same issue. Id. at 979.

Here, the Plaintiffs do not seek to relitigate the constitutionality of Massachusetts IOLTA scheme. Instead, they seek to litigate the constitutionality of a scheme that did not exist until two years after the First Circuit rendered its opinion. While clearly the Plaintiffs assert some of the same legal arguments, they challenge a different statute. Consequently, the Court declines to apply collateral estoppel to this case.

IV. Legislative Immunity

Next, the Justices argue that the claims against them should be dismissed because of legislative immunity. They allege that the Washington Supreme Court acted as a legislative body when it enacted the IOLTA program, and is therefore immune from suit regarding it. Plaintiffs do not dispute that the Washington Supreme Court acted as a legislative body in creating the program.

Both state legislators and U.S. Congressmen enjoy immunity from suits attacking their legislative acts. Supreme Court of Va. v. Consumers Union of the U.S., 100 S. Ct. 1967, 1974-54 (1980). Likewise, both state and federal judges are immune from suits attacking their judicial activities. Id. at 1976. However, state officers who are charged with enforcing laws are not always immune from suits for injunctive or declaratory relief. Id. At 1977. Consequently, the question here is whether this action attacks the Justices' legislative acts in creating the IOLTA program, or whether the action seeks to preclude the Justices from enforcing the program. The Justices contend that they only enacted the program, and that the Limited Practice Board (LPB) has the power to enforce the program.

The United States Supreme Court has recognized that supreme courts may enjoy legislative immunity when the courts promulgate rules that regulate attorneys. See id. at 1977. In Consumers Union, the Supreme Court of Virginia had the virtually exclusive power to regulate the legal profession. Id. at 1969. The court had the power to organize and govern the state bar, which was an administrative agency of the court that investigated and reported violations of the bar code. The court also had the power to prescribe the procedures for attorney discipline, which was vested in an ethics committee, and other committees.

Finally, the court had the exclusive power to discipline attorneys.

The Justices argue that their role in regulating LPOs differs from the Supreme Court of Virginia because there is no Washington statutory code that allows the Washington Supreme Court to initiate enforcement proceedings against LPOs. Neither party cites any state statute that mentions LPOs at all; it appears that LPOs exist only because the Washington Supreme Court created them.

APR 12(b)(1) states that the Washington Supreme Court created the LPB, appoints the members of the LPB, and determines their term of membership. APR (b)(2)(v) states that the LPB shall establish hearing and appeal procedures for discipline violations. That section also states that the LPB "shall take such action as may be appropriate.... [The action] may include admonitions, letters of censure, reprimands, and recommendations to the Supreme Court for the suspension and revocation of the [LPOs'] certification." APR 12(b)(2)(vi) states that the LPB shall "propose regulations to implement the provisions of this rule for adoption by the Supreme Court." APR 12(b)(2)(iii) states that the LPB only has the power to recommend to the Washington Supreme Court whether each LPO applicant should be admitted or rejected from practice.

In sum, APR 12, read as a whole, makes it clear that the LPB has no power independent of the Washington Supreme Court, and has only had procedural, not substantive duties delegated to it. Moreover, the LPB is not directly subject to any other authority. Thus, it appears that if the Washington Supreme Court wanted to have the power to initiate enforcement proceedings, it could pass a rule allowing it. Therefore, the Justices are not immune from suit against enforcing the IOLTA program.

V. Property Interest

No party disputes that owning a property interest is a prerequisite to establishing either a First or Fifth Amendment claim. Once that property interest is established, a taking may occur in either of two ways: By "direct appropriation," or by extensive regulation. Lucas v. South Carolina Coastal Council, 112 S. Ct. 2886, 2892-93 (1992). Plaintiffs argue that two things are taken from them by the IOLTA program. The first is the actual interest accrued, or that would be accrued, in the account. The second is the benefit that the use of the funds brings.

A. IOLTA Account Interest

Plaintiffs first argue that they have a constitutionally recognized property interest in the interest that accrues in the IOLTA accounts. Principally, Plaintiffs rely on Webb's Fabulous Pharmacies v. Beckwith, 101 S. Ct. 446 (1980). In that case, the claimant attacked a Florida statute that allocated money accrued in a Florida interpleader fund as pubic money. Id. at 452. On review, the Supreme Court held that the interest followed the principal, and was thus the property of the claimants. Id. at 451. Plaintiffs argue that Webb's is particularly instructive to the instant situation because the plaintiffs in that action could not insist that their funds were placed in an interest bearing account. Id. However, Plaintiffs do not dispute that the deposit at issue in Webb's earned enough interest to cover administrative and court costs. In other words, there was a positive balance of net interest in that case. Thus, plaintiffs rely on Webb's for the general proposition that interest follows principal.

Two circuits have addressed this question. See, TEAJF, supra, 94 F.3d 996 (5th Cir. 1996), cert. granted sub nom, Phillips v. Washington Legal Foundation, 66

U.S.L.W. 3030 (July 15, 1997); Cone v. State Bar of Florida, 819 F.2d 1002 (11th Cir 1987). The Eleventh Circuit concluded that the client-depositors do not have a property interest in the IOLTA interest; the Fifth Circuit concluded the opposite.

In Cone, the Eleventh Circuit began its analysis by stating that there was no dispute that the funds that were placed into the IOLTA accounts were the property of the client-depositors. Cone 819 F.2d at 1007. The court then recognized and distinguished Webb's because the funds deposited in the IOLTA account could not, absent the IOLTA program, earn a net return for the client-depositors. Id. At 1006 n.6, 1007. Finally, the court emphasized that it did not create a de minimis standard for Fifth Amendment takings claims. Id. at 1007. Instead, the court held that the state had not taken anything that the depositor would have owned, absent the program. Id.

In TEAJF, the Fifth Circuit could find no reason that would justify a departure from the general rule that interest follows principal. TEAJF, 94 F.3d at 1002. In doing so, the Fifth Circuit looked at the actual transactions that take place for the state to earn money on the program. Namely, the Fifth Circuit found that the funds earned interest, and then the bank deducted its charges. Id. at 1003. Consequently, the court found there is a two step process, and that the depositors' ownership of the interest attached the moment that it was earned. Id. The Fifth Circuit also noted that the IOLTA programs can only exist if participation in them is mandatory. Id. This is because the interest is taxable if the depositors have any control over the interest generated in the funds. Id.

Moreover, the Fifth Circuit stated that it did not want to encourage states to look for anomalies in banking and tax laws that would lead to "unclaimed" interest. Id. The court recognized that as technology improves, so will the speed of

banking transactions. Id. At 1004. As the speed of transactions improves, the bank will be able to account and allocate smaller amounts to depositors. Id. In doing so, the Fifth Circuit implied that the costs of banking will reduce, narrowing the gap between the gross and net interest that the depositor can claim.

The Court agrees with the Cone analysis. The Fifth Circuit's reasoning overlooks the fact that in no event can the client-depositors make any net return on the interest accrued in these accounts. Indeed, if the funds were able to make any net return, they would not be subject to the IOLTA program.

When the Fifth Circuit noted that ownership in the interest attached as soon as the interest accrued, it was examining the gross gains of the account. This approach, however, is nearsighted because the bank charges and accounting fees necessarily impose a net loss. Consequently, the client-depositor would, in the end, own a property interest in nothing.

Whether a court should examine the net or gross taking has traditionally arisen in cases where real property is taken. See, e.g., Boston Chamber of Commerce v. City of Boston, 30 S. Ct. 459, 460 (1910). In those situations, the examination has taken place to ascertain damages, not whether the claimant had a property interest in the thing taken. See id. Nonetheless, a rule has developed from these cases, and that rule was aptly stated in Boston Chamber of Commerce: The takings clause "deals with persons, not with tracts of land. And the question is What has the owner lost? Not, What has the taker gained." Id. Here, the client-depositors lose the net gains, which is a negative number. The gross gains do not exist after the netted transaction costs. Consequently, they have lost nothing, and Plaintiffs have no property interest in the IOLTA program interest.

B. Benefit of Credit Earnings

Next, Plaintiffs argue that the IOLTA program unconstitutionally deprives them of the beneficial use of their deposits. Prior to the IOLTA program, the client funds would be placed in non-interest-bearing accounts. Consequently, the banks would have the use of the money without paying interest on it. The banks then awarded earnings credits, based on the average balance of the accounts. The earnings credits subsidized the bank charges, or accounting services performed by a third party. Federal regulations prohibited awarding earnings credits to the client-depositor or the depositor, but not to a non-subsidiary entity that was affiliated with the depositor. Thus, some of the escrow companies formed non-subsidiary accounting service companies, and received the benefit of the credit earnings.

In Washington Legal Found. V. Massachusetts Bar Found., 993 F.2d 962 (1st Cir. 1993), the plaintiffs "eschewed a right to the interest itself, and instead claim[ed] a property right to the beneficial use of their deposited funds, and more specifically, the right to exclude others from the beneficial use of those funds." Id. At 973. The First Circuit concluded that: "The plaintiffs have cited no sources which recognize a similar constitutionally protected right to control or exclude others from intangible property and [the court] found none." Id. at 974. Thus, a claimant must have an ownership interest in the benefit in order to assert that it has been taken. Id. In so holding, the court did not find property rights that "require the exclusion of others to preserve the property interest," see Ruckelshaus v. Monsanto Co., 104 S. Ct. 2862, 2872 (1984), analogous to the IOLTA program.

Plaintiffs assert that the credit earnings reduced the overhead of the escrow companies, and thus were a benefit to the Plaintiffs. Despite Plaintiffs assertions to the

contrary, this necessarily assumes that the program is effecting a regulatory taking because there is no direct appropriation of the earnings credits. See Lucas, 112 S. Ct. at 2893. Plaintiffs do not assert a property interest in the credit earnings themselves. (See, e.g., Plaintiffs' Resp. Justices' Mot. Summ. J. At 9.) Instead, Plaintiffs assert that they have a property interest in the benefit that the earnings credit create. Plaintiffs do not explain how they could have an ownership interest in a benefit when they are precluded by law from having an ownership interest in the thing that creates the alleged benefit. Consequently, there is no property interest in the credit earnings.

VI. Conclusion

In accordance with the foregoing analysis, LFW Defendants' Motion for Summary Judgment and the Supreme Court of Washington's Motion for Summary Judgment are GRANTED. Plaintiffs' Motion for Summary Judgment is DENIED.

SO ORDERED, this 30 day of January, 1998.

John C. Coughenour
UNITED STATES DISTRICT JUDGE

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 98-35154

D.C. No. CV-97-00146-JCC
(Western Washington)
ORDER

WASHINGTON LEGAL FOUNDATION; ALLEN D. BROWN; DENNIS H. DAUGS; GREG HAYES; L. DIAN MAXWELL,
Plaintiffs-Appellants,

v.

LEGAL FOUNDATION OF WASHINGTON; KEVIN F. KELLY; BARBARA DURHAM, Chief Justice; GERRY L. ALEXANDER, Justice; JAMES M. DOLLIVER, Justice; RICHARD P. GUY, Justice; CHARLES WAYNE JOHNSON, Justice; BARBARA A. MADSEN, Justice; CHARLES Z. SMITH, Justice; PHILIP A. TALMADGE, Justice,
Defendants-Appellees.

Filed May 9, 2001

BEFORE: SCHROEDER, Chief Judge

Upon the vote of a majority of nonrecused regular active judges of this court, it is ordered that this case be reheard by the en banc court pursuant to Circuit Rule 35-3. Judges McKeown and Gould were recused. The three-judge panel opinion shall not be cited as precedent by or to this court or any district court of the Ninth Circuit, except to the extent adopted by the en banc court.

APPENDIX E

The Takings Clause of the Fifth Amendment to the United States Constitution provides:

> [N]or shall private property be taken for public use, without just compensation.

WASHINGTON RULES OF PROF. CONDUCT RULE 1.14 - PRESERVING IDENTITY OF FUNDS AND PROPERTY OF A CLIENT

(a) All funds of clients paid to a lawyer or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable interest-bearing trust accounts maintained as set forth in section (c), and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:

(1) Funds reasonably sufficient to pay bank charges may be deposited therein;
(2) Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

(b) A lawyer shall:

(1) Promptly notify a client of the receipt of his or her funds, securities, or other properties;
(2) Identify and label securities and properties of a client promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable;
(3) Maintain complete records of all funds, securities, and other properties of a client coming into the possession of the lawyer and render appropriate accounts to his or her client regarding them;
(4) Promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in the

possession of the lawyer which the client is entitled to receive.

(c) Each trust account referred to in section (a) shall be an interest-bearing trust account in any bank, credit union or savings and loan association, selected by a lawyer in the exercise of ordinary prudence, authorized by federal or state law to do business in Washington and insured by the Federal Deposit Insurance Corporation, the National Credit Union Share Insurance Fund, the Washington Credit Union Share Guaranty Association, or the Federal Savings and Loan Insurance Corporation, or which is a qualified public depository as defined in RCW 39.58.010(2), which bank, credit union, savings and loan association or qualified public depository has filed an agreement with the Disciplinary Board pursuant to rule 13.4 of the Rules for Lawyer Discipline. Interest-bearing trust funds shall be placed in accounts in which withdrawals or transfers can be made without delay when such funds are required, subject only to any notice period which the depository institution is required to reserve by law or regulation.

(1) A lawyer who receives client funds shall maintain a pooled interest-bearing trust account for deposit of client funds that are nominal in amount or expected to be held for a short period of time. The interest accruing on this account, net of reasonable check and deposit processing charges which shall only include items deposited charge, monthly maintenance fee, per item check charge, and per deposit charge, shall be paid to The Legal Foundation of Washington, as established by the Supreme Court of Washington. All other fees and transaction costs shall be paid by the lawyer. A lawyer may, but shall not be required to, notify the client of the intended use of such funds.

(2) All client funds shall be deposited in the account specified in subsection (1) unless they are deposited in:

(i) a separate interest-bearing trust account for the particular client or clients matter on which the interest will be paid to the client; or
(ii) a pooled interest-bearing trust account with subaccounting that will provide for computation of interest earned by each client's funds and the payment thereof to the client.

(3) In determining whether to use the account specified in subsection (1) or an account specified in subsection (2), a lawyer shall consider only whether the funds to be invested could be utilized to provide a positive net return to the client, as determined by taking into consideration the following factors:

(i) the amount of interest that the funds would earn during the period they are expected to be deposited;
(ii) the cost of establishing and administering the account, including the cost of the lawyer's services and the cost of preparing any tax reports required for interest accruing to a client's benefit; and
(iii) the capability of financial institutions to calculate and pay interest to individual clients.

(4) As to accounts created under subsection (c)(1), lawyers or law firms shall direct the depository institution:

(i) to remit interest or dividends, net of reasonable check and deposit processing charges which shall only include items deposited charge, monthly maintenance fee, per item check charge, and per deposit charge, on the average monthly balance in the account, or as

otherwise computed in accordance with an institution's standard accounting practice, at least quarterly, to The Legal Foundation of Washington. Other fees and transaction costs will be directed to the lawyer;
(ii) to transmit with each remittance to the Foundation a statement showing the name of the lawyer or law firm for whom the remittance is sent, the rate of interest applied, and the amount of service charges deducted, if any, and the account balance(s) of the period in which the report is made, with a copy of such statement to be transmitted to the depositing lawyer or law firm.

(5) The Foundation shall prepare an annual report to the Supreme Court of Washington that summarizes the Foundation's income, grants and operating expenses, implementation of its corporate purposes, and any problems arising in the administration of the program established by section (c) of this rule.

(6) The provisions of section (c) shall not relieve a lawyer or law firm from any obligation imposed by these rules with respect to safekeeping of clients' funds, including the requirements of section (b) that a lawyer shall promptly notify a client of the receipt of his or her funds and shall promptly pay or deliver to the client as requested all funds in the possession of the lawyer which the client is entitled to receive.

(d) Escrow and other funds held by a lawyer incident to the closing of any real estate or personal property transaction are client funds subject to this rule regardless of whether the lawyer, the law firm, or the parties view the funds as belonging to clients or nonclients.

WASHINGTON ADMISSION TO PRACTICE RULES
APR 12 - LIMITED PRACTICE RULE
FOR CLOSING OFFICERS

(a) **Purpose.** The purpose of this rule is to authorize certain lay persons to select, prepare and complete legal documents incident to the closing of real estate and personal property transactions and to prescribe the conditions of and limitations upon such activities.

* * * * *

(h) **Treatment of Funds Received Incident to the Closing of Real and Personal Property Transactions.** Except to the extent certified closing officers are not required to be employed in the selection, preparation, and completion of closing documents under APR 12(g)(3), persons admitted to practice under this rule shall comply with APR 12.1 regarding the manner in which they identify, maintain and disburse funds received incidental to the closing of real and personal property transactions.

WASHINGTON ADMISSION TO PRACTICE RULES APR 12.1 - PRESERVING IDENTITY OF FUNDS AND PR0PERTY IN TRANSACTIONS CLOSED BY LIMITED PRACTICE OFFICERS

(a) For the purposes of this rule, the following definitions apply:

"Certified Closing Officer" shall mean an officer licensed in accordance with the procedures set forth in APR 12 and who has maintained his or her certification in accordance with the rules and regulations of the Limited Practice Board.

"Closing Firm" shall mean any bank, depository institution, escrow agent, title company, or other business, whether public or private, that employs or contracts for the services of a certified closing officer for the purpose of providing real or personal property closing services.

"Party" shall mean any person, corporation, partnership, or other entity, including their authorized representatives, having an interest in the real or personal property that is the subject of the transaction being closed by the certified closing officer.

"Transaction" shall mean any real or personal property conveyance requiring the involvement of an attorney or certified closing officer to select, prepare or complete documents for the purpose of closing a loan, extension of credit, sale or other transfer of title to or interest in real or personal property.

(b) For all transactions in which a certified closing officer has prepared documents under the authorization set forth in rule 12(d), the certified closing officer shall insure that all funds received by the closing firm incidental to the closing of the transaction, including advances for costs and expenses, shall be deposited into one or more identifiable

interest-bearing trust accounts maintained as set forth in section (d), and no funds belonging to the certified closing officer or the closing firm shall be deposited therein except as follows:

(1) Funds reasonably sufficient to pay bank charges may be deposited therein;
(2) Funds belonging in part to the parties to the real estate or personal property transaction that is being closed and in part presently or potentially to the certified closing officer or the closing firm must be deposited therein, but the portion belonging to the certified closing officer or the closing firm may be withdrawn when due unless the right of the certified closing officer or the closing firm to receive it is disputed by the parties to the real or personal property transaction, in which event the disputed portion may not be withdrawn until the dispute is finally resolved.

(c) Each trust account referred to in section (b) shall be an interest-bearing trust account in any bank, credit union or savings and loan association, selected by a certified closing officer or the closing firm by which he or she is employed to perform closing services in the exercise of ordinary prudence, authorized by federal or state law to do business in Washington and insured by the Federal Deposit Insurance Corporation, the National Credit Union Share Insurance Fund, or the Washington Credit Union Share Guaranty Association, or which is a qualified public depository as defined in RCW 39.58.010(2), or which bank, credit union, savings and loan association or qualified public depository has filed an agreement with the Disciplinary ~~Board~~ pursuant to rule 13.4 of the Rules for Lawyer Discipline. Interest-bearing trust funds shall be placed in accounts in which withdrawals or transfers can be made without delay

when such funds are required, subject only to any notice period which the depository institution is required to reserve by law or regulation. Such account, if established in the name of the closing firm, must reference the name(s) of the certified closing officer(s) whose services are engaged in connection with the real or personal property closing activities of the closing firm.

(1) A certified closing officer who receives or whose closing firm receives funds associated with a transaction being closed by that officer shall maintain a pooled interest-bearing trust account for deposit of funds that are nominal in amount or expected to be held for a short period of time. The interest accruing on this account, net of reasonable check and deposit processing charges which shall only include items deposited charge, monthly maintenance fee, per item check charge, and per deposit charge, shall be paid to The Legal Foundation of Washington, as established by the Supreme Court of Washington. All other fees and transaction costs shall be paid by the certified closing officer or the closing firm by which he or she is employed to perform closing services. A certified closing officer or closing firm may, but shall not be required to, notify the parties to the transaction of the intended use of such funds.

(2) All funds received from the parties to a transaction being closed by the certified closing officer, whether received by the certified closing officer or the closing firm, shall be deposited in the account specified in subsection (1) unless they are deposited in:

(i) a separate interest-bearing trust account containing funds pertaining to a specific real or personal property

closing if directed by written agreement signed by the parties to the transaction and specifying the manner of distribution of accumulated interest to the parties to the transaction;
(ii) a separate interest-bearing trust account for a particular party to a real or personal property closing on which accumulated interest will be paid to that party; or
(iii) a pooled interest-bearing account with subaccounting that will provide for computation of interest earned by each party's funds and the payment thereof to the respective party.

(3) In determining whether to use the account specified in subsection (1) or an account specified in subsection (2), a certified closing officer shall consider only whether the funds to be invested could be utilized to provide a positive net return to the client, as determined by taking into account the following factors:

(i) the amount of interest that the funds would earn during the period they are expected to be deposited;
(ii) the cost of establishing and administering the account, including the cost of the certified closing officer's services and the cost of preparing any tax reports required for interest accruing to the party(ies)' benefit; and
(iii) the capability of financial institutions to calculate and pay interest to individual parties in the manner contemplated by subsection (2).

(4) As to accounts created under section (d), certified closing officers or the closing firms on whose behalf they are engaged in performing closing services shall direct the depository institution:

(i) to remit interest or dividends, net of reasonable check and deposit processing charges which shall only include items deposited charge, monthly maintenance fee, per item check charge, and per deposit charge, on the average monthly balance in the account, or as otherwise computed in accordance with an institutions standard accounting practice, at least quarterly, to The Legal Foundation of Washington. Other fees and transaction costs will be directed to the certified closing officer of the closing firm by which he or she is employed to perform closing services;
(ii) to transmit with each remittance to the Foundation a statement showing the name of the certified closing officer(s) for whom the remittance is sent, the rate of interest applied, and the amount of service charges deducted, if any, and the account balance(s) of the period in which the report is made, with a copy of such statement to be transmitted to the depositing certified closing officer or closing firm.

(d) Notwithstanding any provision of any other rule, statute, or regulation, escrow and other funds held by a certified closing officer, or the closing firm, incident to the closing of any real or personal property transaction are funds subject to this rule regardless of how the certified closing officer, closing firm, or party(ies) view the funds.

APPENDIX F

THE HONORABLE JOHN C. COUGHENOUR

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

WASHINGTON LEGAL FOUNDATION, *et al.*, Plaintiffs, v. **LEGAL FOUNDATION OF WASHINGTON,** *et al.*, Defendants.	) No. C97-0146C) DECLARATION OF) GERALD R. WHEELER) IN SUPPORT OF) PLAINTIFFS' MOTION) FOR SUMMARY) JUDGMENT

1. I, Gerald R. Wheeler, am over 18 years of age, and am competent to testify about the matters set forth herein. I make this declaration in support of Plaintiffs' Motion for Summary Judgment.

2. I am a C.P.A. licensed in the States of Washington and Oregon. I received a B.S. degree in accounting from the University of California at Berkeley and an M.B.A. degree with emphasis in real estate from Portland State University.

3. A significant part of the work I have performed as a C.P.A. since 1972 has involved the provision of computerized escrow accounting services for banks. I have performed such services in Washington since 1978. Since January 1, 1992, I have operated my own accounting firm in Federal Way, Washington, specializing in computer and related services. I have regularly provided services to more than 100 escrow offices. As a result of that work, I am

intimately familiar with the operations of the escrow industry in Washington.

4. I have had several articles published in the escrow industry trade press on a variety of matters, including: legislative matters affecting the escrow industry, collected funds, IRS information reporting requirements, and IOLTA. I received a special award from the Escrow Association of Washington in September 1987 for contributions to the industry and the association.

5. Historically, escrow companies and title companies have placed customer trust funds into non-interest-bearing checking accounts. The accounts were non-interest-bearing because federal law (since the Depression) has prohibited federally-insured banks and savings and loans from paying interest on checking accounts. Also, Washington law prohibited use of interest-bearing trust accounts for escrow companies unless the interest was paid to the principals or as directed by the principals. WAC 308-128E-011(1).

6. Although federal law now permits banks to offer Negotiable Order of Withdrawal (NOW) accounts (which operate like traditional checking accounts yet are permitted to pay interest), escrow and title companies have never deemed NOW accounts to be realistic options for their trust funds due to the difficulty in crediting the proper amount of interest to each person whose funds have passed through the escrow account. Another reason that NOW accounts have not been employed is that they may not be used for funds belonging to a for-profit corporation, and escrow and title companies often must handle corporate funds. Also, although WAC 308-128E-011(1) was amended in 1996 to permit interest on escrow accounts to be paid to the Legal Foundation of Washington pursuant to APR 12.1, it otherwise remains fully in force.

7. Although Washington banks have not paid interest on escrow accounts, in lieu thereof they have generally pro-

vided what are referred to in the industry as "earnings credits." Although the precise banking terms vary from bank to bank and from customer to customer, these credits generally are based on the amount of funds maintained in the escrow account. The credits can generally be applied against fees that would otherwise be payable to the bank for a variety of services rendered by the bank. Such services include escrow trust accounting services (as described in a staff legal opinion letter of the Board of Governors of the Federal Reserve System dated April 26, 1994; the letter concluded that payment by banks for such services did not constitute the improper payment of interest); and wire transfers. The escrow trust accounting services provided by my C.P.A. firm have usually been paid for by banks; those banks have generally applied the "earnings credits" from escrow accounts against the cost of my services, with the result that the banks have not imposed a net charge against the escrow accounts for my services. Those services are of significant value to those whose funds have been deposited in escrow accounts. The services are particularly valuable in the event of a bank failure: federal deposit insurance is unavailable in excess of $100,000 per escrow account unless the accounting records maintained in good faith from day to day are able to ascertain the separate beneficial interests within the pooled custodial account. A copy of the April 26, 1994 Federal Reserve letter is attached hereto as Exhibit A.

8. Following adoption of APR 12(h) and 12.1, many Washington banks have been unwilling to offer earnings credits on escrow accounts. Bank officials have explained to me that they cannot afford both to pay interest on IOLTA accounts and provide earnings credits. In the absence of such credits, bank customers are now paying for many services that formerly were "free" (in the sense that earnings credits generally were more than sufficient to offset charges imposed for such services). A few banks have found a way

to provide some earnings credits in addition to payment of interest to the IOLTA program, but the earnings credits for trust accounting services are greatly diminished and often insufficient to cover the costs of needed services.

9. Some or all of those costs inevitably are passed along by escrow and title companies to their customers. Some escrow companies have taken to including those bank charges as a separate item on closing statements. Attached hereto as Exhibit B is the closing statement from a recent real estate transaction in Washington in which the escrow company imposed a fee, denominated as an "IOLTA fee," for costs incurred due to the adoption of APR 12(h) and 12.1 and the resulting disappearance of earnings credits. Other escrow companies simply include the bank charges as part of general overhead costs. Because overhead costs are a major factor in determining a company's pricing structure, the bank charges ultimately are borne in whole or in part by escrow customers. This is ironic, in that deposits that generate interest for the IOLTA program belong to those same customers who now have to pay higher costs because bank earnings credits on their deposits are no longer available to subsidize the cost of closing their real estate transactions.

I state under penalties of perjury that based on my personal knowledge the foregoing is true.

s/ Gerald S. Wheeler

Dated: November 3, 1997

[Attachments to the Declaration have not been reprinted.]